KPMG

# Credit impairment

## Handbook

**US GAAP**

July 2026

kpmg.com/us/en/frv

# Contents

New item added in this edition: **


Foreword ..... 1

Acknowledgments ..... 2

About this publication ..... 3

1. Executive summary ..... 6

Subtopic 326-20

2. Scope of Subtopic 326-20 ..... 15

3. Recognition of expected credit losses, writeoffs and recoveries ..... 30

4. Methods to estimate expected credit losses ..... 45

5. Collective assessment ..... 79

6. Contractual term ..... 86

7. Historical loss experience, forecasts and reversion ..... 98

8. No allowance for credit losses ..... 133

9. Credit enhancements ..... 142

10. Practical expedients and simplifications ..... 157

11. [Not used]

12. Purchased financial assets ..... 188

12A. Business combinations and asset acquisitions ..... 232

13. Off-balance sheet credit exposures ..... 248

14. Guarantees ..... 262

15. Other investments in equity method investees ..... 273

16. Net investment in leases ..... 283

17. Specific considerations for insurance entities ..... 297

18. Specific considerations for commercial entities and trade receivables ..... 311

Subtopic 326-30

19. AFS debt securities ..... 320

Relevant to Subtopics 326-20 and 326-30

20. Beneficial interests ..... 361

21. Subsequent events ..... 383

22. [Not used]

23. Presentation ..... 390

24. Disclosures ..... 398

25. Effective dates and transition** ..... 444

Index of changes ..... 450

KPMG Financial Reporting View ..... 453



© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# No one-size-fits-all solution

ASU 2016-13, Measurement of Credit Losses on Financial Instruments (Topic 326), was the culmination of a project that began in the wake of the global financial crisis. This standard marked a significant change – requiring the immediate recognition of estimated credit losses expected to occur over the remaining life of many financial assets. Since issuance, the FASB has collected feedback on the standard; as a result, it has issued various ASUs to amend Topic 326. These include ASUs issued in 2025 that are intended to simplify Topic 326's application for certain assets and to improve consistency of financial reporting for purchased assets.

Topic 326 is particularly impactful for institutions with significant lending activities or investments in debt securities, although it applies to all entities with financial assets. The standard does not prescribe all aspects of the expected credit loss estimate, including the specific method used, thereby providing flexibility for companies to formulate their own approaches to reflect their estimate of expected credit losses.

Our purpose with this Handbook is to help you understand and successfully apply Topic 326. Changes in business practices and the economic environment continue to create new challenges. We intend to continue the dialogue – updating this publication to provide our insights on issues that arise.

Mark Northan and Lisa Blackburn

**Department of Professional Practice, KPMG LLP**

© 2026 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# Acknowledgments

This Handbook has been produced by the Department of Professional Practice (DPP) of KPMG LLP in the United States.

We would like to acknowledge the efforts of the main contributors to this edition:

Sai Kumar Beemisetty

Lisa Blackburn

Danielle Imperiale

Mark Northan

David Poland

We would like to acknowledge current and former members of DPP who contributed significantly to this Handbook: Jennifer Austin, Kimber Bascom, Joon Byun, Darcie Garza, Jennifer Murphy, Scott Muir, Mahesh Narayanasami, Jack Pohlman, Joan Rood, Julie Santoro and Jennifer Stemple.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# About this publication

The purpose of this Handbook is to assist you in understanding Topic 326.

## Organization of the text

Each chapter of this Handbook includes excerpts from the *FASB Accounting Standards Codification*® and overviews of the relevant requirements.

Our in-depth guidance is explained through Q&As that reflect the questions we are encountering in practice. We include examples to explain key concepts.

Our commentary is referenced to the Codification and to other literature, where applicable. The following are examples.

- 326-20-30-1 is paragraph 30-1 of ASC Subtopic 326-20.
- ASU 2016-13.BC68 is paragraph 68 of the basis for conclusions to ASU 2016-13.
- TRG 6-17.1 is agenda paper No. 1 from the meeting of the FASB's Transition Resource Group for Credit Losses (TRG) held in June 2017.
- Agency FAQ is the joint statement issued by the Board of Governors of the Federal Reserve System (FRB), the Federal Deposit Insurance Corporation (FDIC), the National Credit Union Administration (NCUA), and the Office of the Comptroller of the Currency (OCC), which includes frequently asked questions about ASU 2016-13.
- 2018 AICPA Conf is the 2018 AICPA Conference on Current SEC and PCAOB Developments.
- Reg S-K 10(f)(1) is Item 10(f)(1) of SEC Regulation S-K.

## July 2026 edition

The July 2026 edition of our Handbook includes the following:

- updates to incorporate the guidance in ASU 2025-05, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets, and ASU 2025-08, Financial Instruments – Credit Losses (Topic 326): Purchased Loans; and
- updates for new and updated interpretations based on our experience with companies applying Topic 326.

Compared to the May 2025 edition, new sections, Questions and Examples are identified with ** and items that have been significantly updated or revised are identified with #. A summary is included in the Index of changes.

## Pending content

This edition of the Handbook incorporates amendments to Topic 326 from the following ASUs:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- ASU 2025-05, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets. The amendments in this ASU are effective for annual and interim periods in fiscal years beginning after December 15, 2025, with early adoption permitted.
- ASU 2025-08, Financial Instruments – Credit Losses (Topic 326): Purchased Loans. The amendments in this ASU are effective for annual and interim periods in fiscal years beginning after December 15, 2026, with early adoption permitted.
- ASU 2025-12, Codification Improvements. The amendments in this ASU are effective for annual and interim periods in fiscal years beginning after December 15, 2026. Early adoption is permitted.

The Codification excerpts containing the amendments for these ASUs are reproduced as if the pending content were currently effective for all entities – i.e. the amendments are not labeled as pending content.

In contrast, the Codification amendments from the following ASUs are presented in Codification excerpts as pending content:

- ASU 2024-03, Income Statement – Reporting Comprehensive Income – Expense Disaggregation Disclosures (Subtopic 220-40), are labeled as pending content in the Codification excerpts. The amendments in this ASU are effective for annual reporting periods in fiscal years beginning after December 15, 2026, and interim reporting periods beginning in fiscal years beginning after December 15, 2027, with early adoption permitted.
- ASU 2025-11, Interim Reporting (Topic 270) – Narrow-Scope Improvements. The amendments in this ASU will be effective for PBEs for interim periods in fiscal years beginning after December 15, 2027, and for other entities for interim periods in fiscal years beginning after December 15, 2028. Early adoption is permitted.

Our interpretive guidance presumes they have not been adopted.

When an excerpt from the Codification is affected by pending content:

- the specific sentences that have been superseded are struck out and the added text is underlined; and
- the amended sentences are marked as pending content.

## Abbreviations

We use the following abbreviations in this Handbook.

| | |
|---|---|
| AFS | Available-for-sale |
| EIR | Effective interest rate |
| DIEP | AICPA's Depository Institutions Expert Panel |
| HTM | Held-to-maturity |
| OTTI | Other-than-temporary impairment |
| PBE | Public business entity |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| PCD | Purchased financial assets with credit deterioration |
| PCI | Purchased credit impaired loans accounted for under ASC 310-30 |
| PSL | Purchased seasoned loans |
| SRC | Smaller reporting company |
| TRG | FASB's Transition Resource Group for Credit Losses |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 1. Executive summary

New item added in this edition: **
Item significantly updated in this edition: #

## What's in the scope of Topic 326?

### More than just financial assets measured at amortized cost

Topic 326 applies to all entities. It is divided into two substantive subtopics – Subtopic 326-20 and Subtopic 326-30 – each of which contains a different credit loss model.

| Subtopic 326-20 applies to: | Subtopic 326-30 applies to: |
|---|---|
| Financial assets measured at amortized cost | AFS debt securities |
| Net investments in leases | |
| Off-balance sheet credit exposures not accounted for as insurance | |

The FASB decided that the measurement attribute for AFS debt securities necessitates a separate credit loss model. Moreover, financial assets measured at fair value through net income are excluded from the scope of both Subtopics.

## Credit loss model under Subtopic 326-20

The credit loss model under Subtopic 326-20 is called the 'expected credit loss' model because it requires estimating and recognizing credit losses for the lifetime of assets within its scope. Subtopic 326-20 requires lifetime expected credit losses of a financial asset to be recognized when the asset is purchased or originated. Credit losses are recognized using an allowance approach, with subsequent changes in expected credit losses (favorable and unfavorable) recognized immediately in net income by adjusting the allowance.

### Flexibility to select the method

Subtopic 326-20 does not prescribe all aspects of the expected credit loss estimate, including the specific method to be used. However, it describes how an entity should estimate expected credit losses based on the type of method used.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Method | Allowance calculation |
|---|---|
| **Discounted cash flow method** | The allowance for credit losses reflects the difference between:<br>• the amortized cost basis; and<br>• the present value of the principal and interest cash flows expected to be collected. |
| **Other methods** | The allowance for credit losses reflects the entity's expected credit losses of the amortized cost basis. |

## Pooling is required

Subtopic 326-20 requires that an entity estimate expected credit losses of financial assets with similar risk characteristics on a collective (pool) basis.

A financial asset is measured individually only if it does not share similar risk characteristics with other financial assets.

Both credit and non-credit related characteristics are relevant in determining whether certain assets share similar risk characteristics.

## Contractual term is critical

Subtopic 326-20 requires an entity to estimate expected credit losses over a financial asset's contractual term, adjusted for prepayments. Therefore, the determination of the contractual term will generally significantly affect the size of the allowance for credit losses. In general, the longer the contractual term, the larger the allowance for credit losses.

Certain features of a financial asset can make determining its contractual term more complex, including:

- options to extend the contractual term;
- call options; and
- expected prepayments.

There are also some specific considerations for estimating the life of credit card receivables and determining the contractual term for net investments in leases.

## Historical losses are the starting point

The estimate of expected credit losses is based on relevant information about past events, current economic conditions, and reasonable and supportable forecasts of future economic conditions that affect the collectibility of the reported amounts. Historical loss experience is generally the starting point for estimating expected credit losses.

Adjustments are made to historical loss experience to reflect differences in:

- **asset-specific risk characteristics** – e.g. underwriting standards, portfolio mix or asset terms; and
- **economic conditions** – both current conditions and reasonable and supportable forecasts of future conditions. If an entity is not able to make or obtain reasonable and supportable forecasts of future economic conditions

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

for the entire life of the financial asset, it is required to estimate expected credit losses for the remaining life using an approach that reverts to historical credit loss information.

## Recoveries are considered

Subtopic 326-20 requires an entity to write off financial assets that it deems uncollectible. When estimating lifetime expected credit losses, an entity considers expected recoveries of amounts previously written off and expected to be written off. In limited circumstances, this may result in the allowance for credit losses being negative.

## Not everything needs an allowance for credit losses

Generally, Subtopic 326-20 requires that an allowance for credit losses be estimated and recognized for financial assets measured at amortized cost within its scope. However, it contains an exception for financial assets with a zero loss expectation.

If there is an expectation that a financial asset will have a zero loss, then an entity is not required to estimate or recognize an allowance for credit losses.

## Credit enhancements have a role to play

In developing its estimate of credit losses under Topic 326, an entity considers how credit enhancements that are not freestanding contracts mitigate expected credit losses.

In contrast, an entity recognizes and measures credit enhancements that are freestanding contracts (e.g. credit default swaps) separately from the underlying financial instrument that is subject to Topic 326.

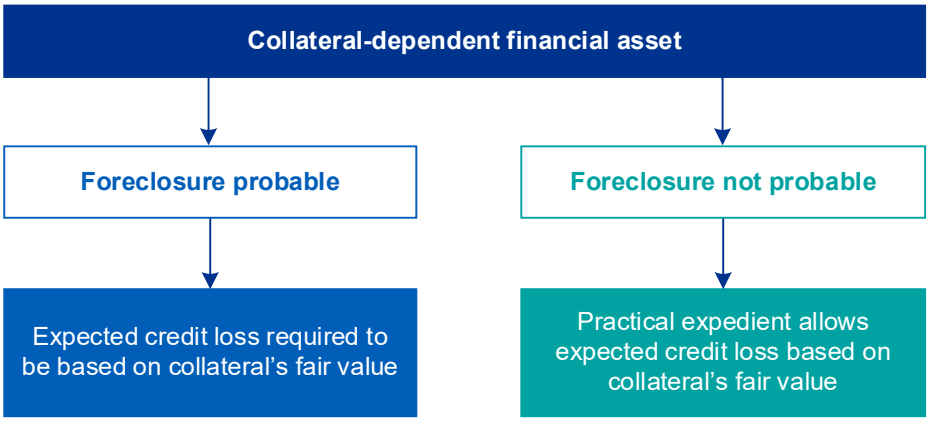
Determining whether a credit enhancement contract is freestanding or is embedded in another financial instrument requires judgment and consideration of all facts and circumstances.

## Collateral-dependent assets treated differently

The principles for estimating expected credit losses of collateral-dependent assets differ from the general measurement principles under the expected credit loss model.

A financial asset is collateral-dependent when the debtor is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. Subtopic 326-20 includes specific guidance regarding the estimation of expected credit losses for collateral-dependent financial assets.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.




## Assets with collateral-maintenance provisions

The principles for estimating expected credit losses of assets with collateral-maintenance provisions differ from the general measurement principles under the expected credit loss model.

A financial asset has a collateral-maintenance provision if it requires the borrower to continually adjust the amount of collateral securing the financial asset as a result of changes in the collateral's fair value. As a practical expedient, when the borrower is expected to replenish the collateral as required by the terms of such an agreement, Subtopic 326-20 permits an entity to estimate expected credit losses for any difference between the financial asset's amortized cost basis and the fair value of collateral securing the financial asset.

## Simplified guidance for current accounts receivable and contract assets**

The principles for estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers) differ from the general measurement principles under the expected credit loss model.

An entity may elect to assume that current conditions as of the balance sheet date remain unchanged for those assets, eliminating the need to forecast future economic conditions. Additionally, an entity that is not a PBE may elect an accounting policy to consider subsequent collection activity after the balance sheet date if it has also elected to assume current conditions as of the balance sheet date remain unchanged.

## Purchased financial assets – credit deteriorated assets and purchased seasoned loans#

Subtopic 326-20 provides different accounting requirements for initial recognition and measurement of purchased financial assets with credit deterioration (PCD assets) and purchased seasoned loans (PSLs). An entity records PCD assets and PSLs at the purchase price plus the allowance for

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

credit losses (expected credit losses) at the time of acquisition, which is referred to as 'gross-up' accounting.

Under this method, there is no credit loss expense affecting net income on acquisition. Changes in estimates of expected credit losses after acquisition are recognized as credit loss expense (or reversal of credit loss expense) in subsequent periods as they arise.

There is also specific guidance for PCD beneficial interests and for PCD AFS debt securities.

## It's not just assets on the balance sheet

The expected credit loss model under Subtopic 326-20 applies to off-balance sheet credit exposures such as unfunded loan commitments and standby letters of credit.

A liability for expected credit losses for off-balance sheet credit exposures is recognized if both of the following conditions are met:

- the entity has a present contractual obligation to extend the credit; and
- the obligation is not unconditionally cancellable by the entity.

Loan commitments may have a funded and an unfunded portion.

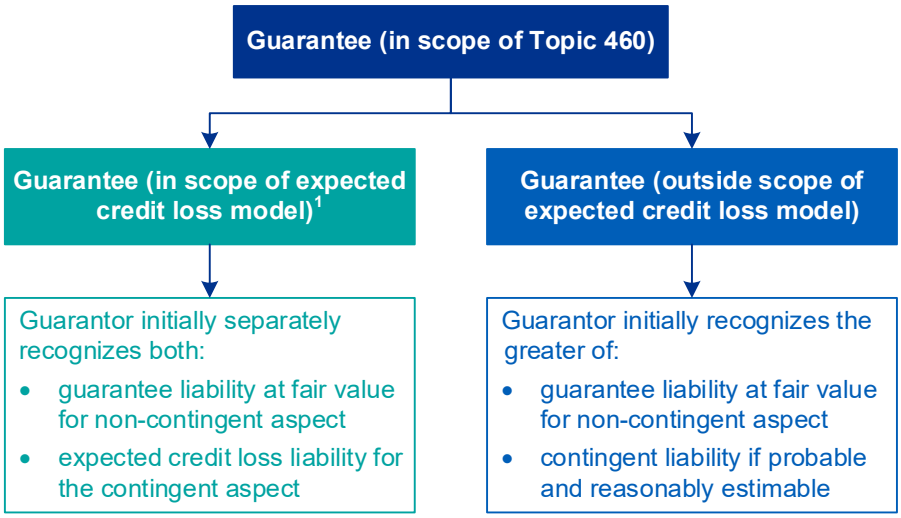
| Portion | Accounting |
|---|---|
| **Funded portion** | Expected credit losses are estimated under the same guidance used for estimating expected credit losses for other financial assets in the scope of Subtopic 326-20.<br>The expected credit losses for funded portions are reported in an allowance for credit losses. |
| **Unfunded portion of loan commitments that are not unconditionally cancellable by the lender** | Expected credit losses are estimated over the contractual term of the loan that will be originated. Subtopic 326-20 requires the estimate of expected credit losses to consider both:<br>• the likelihood that funding will occur; and<br>• an estimate of expected credit losses on commitments expected to be funded.<br>The expected credit losses for unfunded portions are reported as a liability for off-balance sheet credit losses. |
| **Unfunded portion of loan commitments that are unconditionally cancellable by the lender** | An estimate of expected credit losses is not established. |

## Guarantees can have expected credit losses

Guarantees in the scope of Topic 460 that create off-balance sheet credit exposure for the guarantor are also in the scope of Subtopic 326-20.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The contingent aspect of these guarantees is accounted for separately from the guarantee liability (non-contingent aspect) accounted for under Topic 460. Subtopic 326-20's expected credit loss model is applied to the contingent aspect.




Note:

1. Guarantees that create off-balance sheet credit exposure are within scope of Subtopic 326-20.

## Transactions with equity method investees

Topic 326 and Subtopic 323-10 interact when an entity (investor) holding an equity method investment provides additional financial support through financial assets subject to Topic 326 – e.g. a loan to the investee or an investment in debt securities issued by the investee.

# Credit loss model under Subtopic 326-30

The guidance in Subtopic 326-30 applies to all AFS debt securities, including loans accounted for as AFS debt securities. Although Subtopic 326-30 replaced the legacy US GAAP OTTI model with a credit loss model, it retained an essential aspect of that model – that entities are required to determine the amount of credit losses, if any, when securities are impaired. An AFS debt security is impaired when the fair value declines below its amortized cost basis.

Subtopic 326-30 requires credit losses on AFS debt securities to be assessed at the individual security level. A decline in fair value is due to a credit loss to the extent the entity does not expect to recover the amortized cost basis. If an entity does not intend to sell the debt security and it is not more likely than not that it will be required to sell the security before recovery of the amortized cost basis, only the decline in fair value due to a credit loss is recognized through net income. Any portion of the decline that is due to factors other than a credit loss is recognized in other comprehensive income, net of applicable taxes.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Credit losses are recognized using an allowance approach, with amounts written off when deemed uncollectible or when the entity intends to sell (or more likely than not will be required to sell) the debt security before recovery of the amortized cost basis. Reversals of credit losses are recognized immediately; however, the allowance for credit losses cannot be negative.

# Effects beyond Topic 326

## Beneficial interests

Subtopic 325-40 addresses how to account for credit losses on beneficial interests, including how changes in credit losses affect accretable yield.

The appropriate accounting treatment for beneficial interests in the scope of Subtopic 325-40 depends on whether they are classified as HTM or AFS and whether they are PCD beneficial interests.

The credit loss guidance on PCD financial assets applies to a beneficial interest that meets the definition of PCD or that has a significant difference between contractual and expected cash flows when acquired.

The following table summarizes the four different accounting models applicable to beneficial interests that are in the scope of Subtopic 325-40.

| Beneficial interests classification | Accounting for PCD assets is applied | Accounting for PCD assets is *not* applied |
|---|---|---|
| **Held-to-maturity** | Initial estimate of expected credit losses is recognized as an allowance through a gross-up that increases the amortized cost basis of the asset with no effect on net income at initial recognition.<br>Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If a favorable change in expected cash flows is not fully recognized through a decrease to the allowance (including a negative allowance), the accretable yield is adjusted on a prospective basis. | No allowance at initial recognition.<br>Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If a favorable change in expected cash flows is not fully recognized through a decrease to the allowance (including a negative allowance), the accretable yield is adjusted on a prospective basis. |
| **Available-for-sale** | Initial estimate of expected credit losses is recognized as an allowance through a gross-up that increases the amortized cost basis of the asset with no effect on net income at initial recognition. | No allowance is recognized at initial recognition.<br>If a decline in fair value below amortized cost results from credit losses, an allowance is recognized through net income. Subsequent favorable or adverse changes in |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Beneficial interests classification | Accounting for PCD assets is applied | Accounting for PCD assets is *not* applied |
|---|---|---|
| | Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If the allowance has been reduced to zero (due to favorable changes) or met the fair value floor (due to adverse changes), the accretable yield is adjusted on a prospective basis. | expected cash flows first decrease or increase the allowance for credit losses. If the allowance has been reduced to zero (due to favorable changes) or has met the fair value floor (due to adverse changes), the accretable yield is adjusted on a prospective basis. |

## Subsequent events

Subtopic 855-10 requires changes in estimates of credit losses arising after the reporting date to be considered Type II (disclosure-only) subsequent events. However, in a speech at the 2018 AICPA Conference on Current SEC and PCAOB Developments, the SEC staff provided its view that information received after the reporting date that is asset-specific information about factual conditions that existed at the reporting date should be reflected in the financial statements.

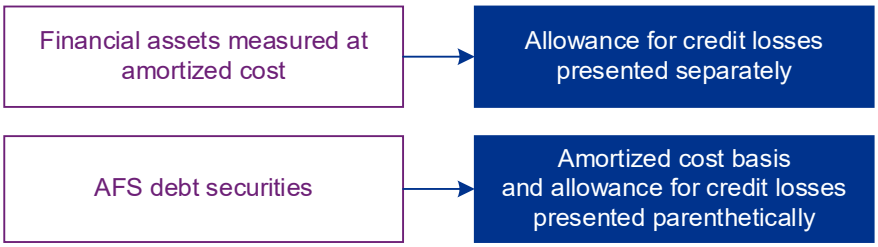
Additionally, the SEC staff provided its view about information received after the reporting date that relates to forecasting assumptions. The staff indicated that whether the information should be reflected in the financial statements depends on whether it indicates there was a weakness or deficiency in the entity's estimation process.

- If there was a weakness or deficiency, the information should be reflected in the financial statements.
- If there was not a weakness or deficiency, the approach depends on when the information was received.
  - If the information was received *before* the estimation process was complete, the entity may choose whether or not to reflect the information in the financial statements.
  - If the information was received *after* the estimation process was complete, the entity should not reflect the information in the financial statements.

# Presentation and disclosures

Financial assets measured at amortized cost and AFS securities are presented differently under Topic 326.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.




Topic 326 requires disclosure of both qualitative and quantitative information about an entity's financial assets and the allowance for credit losses. The objective of these disclosures is to help financial statement users understand:

- the credit risk inherent in an entity's portfolio of financial assets;
- how management monitors the portfolio's credit quality;
- management's estimate of expected credit losses; and
- changes in the estimate of expected credit losses that have taken place during the period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 2. Scope of Subtopic 326-20

## Detailed contents

**2.1 How the standard works**

**2.2 Instruments in scope**

2.2.10 Overview

**Questions**

**Question 2.2.10** Are cash equivalents in the scope of Subtopic 326-20?

**Question 2.2.20** Is preferred stock in the scope of Topic 326?

**Question 2.2.30** Are perpetual preferred securities in the scope of Subtopic 326-20?

**Question 2.2.40** Are held-for-sale loans in the scope of Subtopic 326-20?

**Question 2.2.50** Are investments in bank-owned, corporate-owned or split-dollar life insurance policies in the scope of Subtopic 326-20?

**Question 2.2.60** Are tax receivables from taxing authorities in the scope of Subtopic 326-20?

**Question 2.2.70** Is an off-balance-sheet credit exposure in the scope of Subtopic 326-20 if it relates to a financial asset that is not?

**Question 2.2.80** Are supplier advances in the scope of Subtopic 326-20?

**Question 2.2.90** Are repurchase arrangements related to transferred loans in the scope of Subtopic 326-20?

**Question 2.2.100** Are indemnification assets arising from business combinations in the scope of Subtopic 326-20?

**Question 2.2.110** Are guarantees between entities under common control that relate to a third-party credit exposure in the scope of Subtopic 326-20?

**Examples**

**Example 2.2.10** Guarantees of operating lease payments to the lessor

**Example 2.2.20** Accounting for guarantees between entities under common control that relates to third-party credit exposure

**2.3 Explicit scope exclusions**

2.3.10 Overview

**Questions**

**Question 2.3.10** Is there a difference in the timing and amount of credit losses when a debt security is classified as HTM rather than AFS?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 2.3.20** When does the scope exclusion for loans and receivables between entities under common control apply?

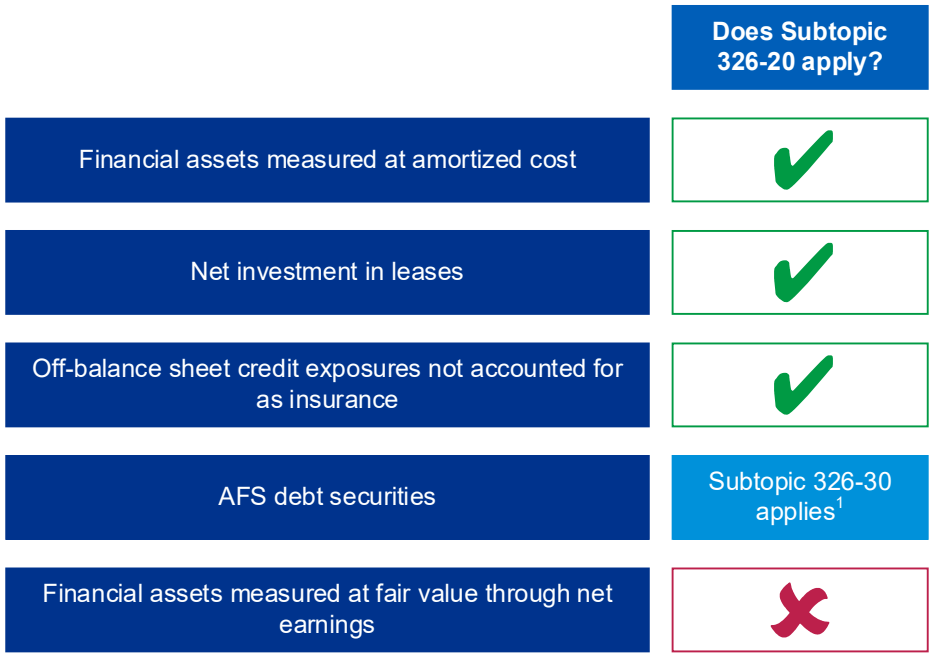
**Question 2.3.30** Are assets that arise from recognizing lease income on a straight-line basis in the scope of Subtopic 326-20?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 2.1 How the standard works

The expected credit loss guidance in Topic 326 applies to all entities. It is divided into two substantive subtopics – Subtopic 326-20 and Subtopic 326-30 – each of which contains a different credit loss model.

This chapter discusses the types of financial assets in the scope of Subtopic 326-20.




Note:

1. The FASB decided that the measurement attribute for AFS debt securities necessitated a separate credit loss model. Subtopic 326-30 is discussed in chapter 19.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 2.2 Instruments in scope

### 2.2.10 Overview

#### Excerpt from ASC 326-20

> Instruments

**15-2** The guidance in this Subtopic applies to the following items:

a. Financial assets measured at amortized cost basis, including the following:
   1. **Financing receivables**
   2. Held-to-maturity **debt securities**
   3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition, Topic 606 on revenue from contracts with customers, and Topic 610 on other income
   4. Subparagraph superseded by Accounting Standards Update No 2019-04.
   5. Receivables that relate to repurchase agreements and securities lending agreements within the scope of Topic 860
b. Net investments in leases recognized by a lessor in accordance with Topic 842 on leases
c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging
d. **Reinsurance recoverables** that result from insurance transactions within the scope of Topic 944 on insurance.

**20 Glossary**

**Financing Receivable**

A financing arrangement that has both of the following characteristics:

a. It represents a contractual right to receive money in either of the following ways:
   1. On demand
   2. On fixed or determinable dates.
b. It is recognized as an asset in the entity's statement of financial position.

See paragraphs 310-10-55-13 through 55-15 for more information on the definition of financing receivable, including a list of items that are excluded from the definition (for example, debt securities).

#### Excerpt from ASC 310-10

• • > Meaning of *Financing Receivable*

**55-13** This implementation guidance addresses the meaning of the term **financing receivable**.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**55-14** All of the following are examples of **financing receivables**:

a. Loans
b. Trade accounts receivable
c. Notes receivable
d. Credit cards
e. Receivables relating to a lessor's right(s) to payment(s) from a **leveraged lease** that should be recognized as an asset in accordance with paragraphs 842-10-65-1(z)…
f. **Lease receivables** arising from **sales-type leases** or **direct financing leases**.

**55-15** None of the following meet the definition of financing receivables:

a. **Debt securities** within the scope of Topic 320 (see the guidance beginning in paragraph 320-10-15-5)
b. Unconditional promises to give (for example, contributions receivable) that should be recognized as an asset in accordance with paragraphs 958-605-25-7 through 25-15
c. Both of the following instruments, which are within the scope of Subtopic 5-25-7 through 25-15 325-40:
    1. A transferor's interests in securitization transactions that are accounted for as sales under Topic 860
    2. Purchased beneficial interests in securitized financial assets.

For related guidance, see paragraph 325-40-15. [KPMG Note 1]

Note:

1. The word 'paragraph' is a typographical error in the FASB Codification; it should be 'Section'.

The guidance on expected credit losses in Subtopic 326-20 applies to many assets measured at amortized cost. As discussed in section 2.3, certain instruments are excluded from the scope of Subtopic 326-20. [326-20-15-2]

## **Question 2.2.10** Are cash equivalents in the scope of Subtopic 326-20?

**Interpretive response:** It depends. Cash equivalents are short-term highly liquid investments that are:

- readily convertible to known amounts of cash; and
- so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. [305-10 Glossary]

Cash equivalents may include US Treasury bills, commercial paper, money market funds, certificates of deposit, balances with the Federal Reserve Banks and the Federal Home Loan Banks and federal funds sold.

Cash equivalents that are financial assets measured at amortized cost (e.g. US Treasury bills) are in the scope of Subtopic 326-20. Nevertheless, if there is an expectation that a financial asset will have a zero loss (i.e. a 'zero loss expectation'), an entity is not required to estimate expected credit losses for

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

these instruments. For a discussion of how to determine whether the zero loss expectation exception applies to a financial asset, see chapter 8.

## **Question 2.2.20** Is preferred stock in the scope of Topic 326?

**Interpretive response:** It depends. The legal form of an instrument does not always determine whether a security should be accounted for as an equity security (in the scope of Topic 321) or a debt security (in the scope of Topic 326).

Preferred stock that meets the definition of a debt security is in the scope of Subtopic 326-20 (if classified as HTM) and Subtopic 326-30 (if classified as AFS).

The definition of a debt security includes preferred stock that, by its terms, either: [320-10 Glossary]

- must be redeemed by the issuing entity; or
- is redeemable at the option of the holder.

Additionally, the definition of equity securities specifically excludes preferred stock that by its terms either must be redeemed by the issuing entity or is redeemable at the option of the investor. [320-10 Glossary]

We believe that for a preferred share that is redeemable at the option of the investor to be classified as a debt security (in the scope of Topic 326), the investor must have the unilateral ability to redeem its investment. Additionally, the investor's determination of whether an investment in preferred stock meets the definition of a debt or equity security will not necessarily align with the issuer's balance sheet classification. For example, there may be instances where the investor concludes that its investment in a preferred share meets the definition of a debt security, while the issuer classifies the preferred share as equity (e.g. temporary equity) in its financial statements.

The following chart illustrates different preferred stock redemption options, the associated classification, and whether we believe it is in the scope of Topic 326.

| Preferred share redemption option | Classification |
|---|---|
| **Redemption option is currently exercisable by the investor** | Debt security (in scope of Topic 326) |
| **Redemption option is time-based – i.e. it will become exercisable by the investor following the passage of time** | Debt security (in scope of Topic 326) |
| **Redemption option will become exercisable by the investor on the occurrence of a contingent event outside the investor's control** | Equity security (outside scope of Topic 326) |

See section 2.3 of KPMG Handbook, Investments, for guidance on distinguishing between debt securities (in the scope of Topic 326) and equity securities.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 2.2.30** Are perpetual preferred securities in the scope of Subtopic 326-20?

**Interpretive response:** No. As discussed in Question 2.2.20, preferred stock that neither requires redemption by the issuer nor is redeemable at the option of the holder is an equity security and is therefore outside of the scope of Subtopic 326-20.

Perpetual preferred securities are often issued in equity form but possess significant debt-like characteristics, such as periodic dividends and issuer call features. Therefore, their credit ratings are similar to debt securities and they are priced similarly to callable bonds.

Before the issuance of ASU 2016-13, the SEC staff had issued guidance relating to the assessment of OTTI of equity securities – such as high-quality perpetual preferred stock – that are similar to debt instruments. The SEC staff indicated that because of the challenges with assessing OTTI for perpetual preferred stock, it would not object to applying an impairment model (including an anticipated recovery period) similar to the model applicable to debt securities if there has been no evidence of deterioration in the credit of the issuer. However, the perpetual preferred stock would otherwise continue to be treated as an equity security by the holder.

Because perpetual preferred securities are equity securities, the guidance in Topic 321 – created by ASU 2016-01 (Recognition and Measurement of Financial Assets and Financial Liabilities) – applies. These securities are measured at fair value through net income unless they do not have a readily determinable fair value and the measurement alternative described in paragraph 321-10-35-2 is elected. If the measurement alternative is elected, these securities are subject to the specific impairment guidance in Subtopic 321-10. See KPMG Handbook, Investments. [321-10-35-1 – 35-4]

## **Question 2.2.40** Are held-for-sale loans in the scope of Subtopic 326-20?

**Interpretive response:** No. Held-for-sale loans are not in the scope of Subtopic 326-20 because they are reported at the *lower of* amortized cost or fair value, rather than *at* amortized cost. A valuation allowance is recorded for the amount by which the amortized cost basis of a held-for-sale loan exceeds its fair value. [948-310-35-2]

See section 3.2.20 for considerations when a loan is transferred into or out of the held-for-sale category, including the effect on the related valuation allowance or allowance for credit losses, as applicable.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 2.2.50** Are investments in bank-owned, corporate-owned or split-dollar life insurance policies in the scope of Subtopic 326-20?

**Interpretive response:** No. Investments in bank-owned life insurance (BOLI), corporate-owned life insurance (COLI) or split-dollar life insurance policies are not in the scope of Subtopic 326-20 because they are not measured at amortized cost.

Investments in BOLI, COLI and split-dollar life insurance are subject to Subtopic 325-30 (investments in insurance contracts), which requires these investments to be measured at the amount that could be realized under the life insurance contract. That amount includes consideration of amounts included in the contractual terms of the policy, such as cash surrender value, deferred acquisition costs, tax and claims stabilization reserves. [325-30-30-1, 35-1, 55-1]

This measurement does not represent amortized cost and these investments are not otherwise included in the scope of Subtopic 326-20.

## **Question 2.2.60** Are tax receivables from taxing authorities in the scope of Subtopic 326-20?

### Excerpt from ASC 326-20

**20 Glossary**

**Financial Asset**

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

a. Receive cash or another financial instrument from a second entity
b. Exchange other financial instruments on potentially favorable terms with the second entity

**Interpretive response:** Generally, no. To be a financial asset, a receivable must result from a contractual right. In contrast, a tax receivable from a taxing authority (e.g. a refund resulting from overpayment of income taxes) generally is not the result of a contract. Rather, it is the result of a taxing authority's legal right to impose a tax on the taxpayer. Because tax receivables that do not arise from a contract are not financial assets and are not otherwise included, they are not in the scope of Subtopic 326-20.

In contrast, when a tax receivable from a taxing authority is incorporated into a contract that meets the definition of a financial asset, that financial asset is subject to Subtopic 326-20. Examples include tax receivables that have been contractually reduced to a fixed payment schedule through: [860-10-55-10 – 55-11]

- contractual settlement agreements; or
- judgments from litigation that are enforceable by a government or a court of law.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 2.2.70** Is an off-balance-sheet credit exposure in the scope of Subtopic 326-20 if it relates to a financial asset that is not?

**Interpretive response:** Yes, we believe such a credit exposure is generally in the scope of Subtopic 326-20 unless it is explicitly excluded (see section 2.3.10).

Subtopic 326-20 specifically includes in its scope "credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815." The off-balance sheet exposures described in this scope inclusion are not limited to exposures relating to financial assets in the scope of Subtopic 326-20. [326-20-15-2(c)]

## **Example 2.2.10** Guarantees of operating lease payments to the lessor

ABC Corp. is the lessee in a lease of retail space classified as an operating lease. ABC sells its retail operations to XYZ Corp. and assigns the operating lease to XYZ – i.e. it substitutes XYZ for itself in the lease agreement.

Lessor permits that assignment such that ABC is relieved of the primary obligation under the original lease. However, ABC remains secondarily liable for making the lease payments to Lessor in the event of XYZ's non-performance – i.e. ABC guarantees XYZ's payment of amounts payable to Lessor under the lease agreement. This guarantee results in ABC having off-balance sheet credit exposure. ABC concludes that the guarantee is not in the scope of Topic 815.

Although Lessor's operating lease receivables are outside the scope of Subtopic 326-20 (see section 2.3.10), ABC's guarantee of those amounts is not explicitly excluded from the scope of Subtopic 326-20. Therefore, because it is not in the scope of Topic 815, ABC's guarantee of Lessor's operating lease payments from XYZ is in the scope of Subtopic 326-20.

## **Question 2.2.80** Are supplier advances in the scope of Subtopic 326-20?

**Background:** Some entities are required under their supply arrangements to advance amounts to suppliers as prepayment of expected future deliveries of goods or services (referred to as 'supplier advances'). These prepayments may be provided for a variety of reasons, including to protect the supplier against nonpayment or to cover the supplier's out-of-pocket costs for supplying the service or product. Under the terms of the arrangement, the supplier is not required to refund the advance unless it fails to deliver the agreed upon goods or services. The entity that makes the advance recognizes an asset when the payment is made.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Interpretive response:** No. The asset recognized by the entity relates to its right to receive goods or services from the supplier. It does not represent a financial asset because it does not convey to the entity a right to receive cash or another financial instrument, or to exchange other financial instruments. Because a supplier advance is not a financial asset and is not otherwise included in the scope of Subtopic 326-20, it is outside the scope of that Subtopic. [326-20 Glossary]

## **Question 2.2.90** Are repurchase arrangements related to transferred loans in the scope of Subtopic 326-20?

**Background:** Bank (the transferor) originates residential mortgage loans for sale or securitization in secondary market transactions. Those transfers are accounted for as sales under Topic 860. In connection with the transfers, Bank has certain contingent arrangements to repurchase the loans from the transferees. The repurchase price is an amount greater than the fair value of the loans.

**Interpretive response:** We believe a repurchase arrangement is in the scope of Subtopic 326-20 if all of the following conditions are met.

- If the repurchase arrangement arose from a previous transfer, the transfer was accounted for as a sale under Topic 860.
- The contingent event triggering the repurchase arrangement is credit-related. [326-20-15-2(c)]
- The obligation to repurchase is outside the transferor's control. We believe this condition must be met because an entity does not estimate a liability for off-balance sheet credit exposures when the entity can unconditionally cancel the obligation (see section 13.3.10).
- The repurchase arrangement is not accounted for as a derivative instrument in the scope of Topic 815.

The following table summarizes examples of common repurchase arrangements and whether each is in the scope of Subtopic 326-20. The examples assume that the related transfer is appropriately accounted for as a sale under Topic 860.

| Description | In scope of Subtopic 326-20? |
|---|---|
| **Standard representations and warranties[1]** | |
| Bank makes representations and warranties to the transferees about the sold loans. Those representations and warranties specifically relate to:<br>• the underwriting standards that were followed in originating the loans; and<br>• the accuracy and completeness of the loan documents.<br>When the transferee determines that a standard representation or warranty has | No. We believe the contingent event triggering repurchase arrangements related to standard representations and warranties is an operational/legal risk and not credit related. [326-20-55-81– 55-82]<br>The transferee can require Bank to repurchase a loan under this arrangement regardless of whether a credit-related event (e.g. a default or other deterioration in credit quality since origination) has occurred. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Description | In scope of Subtopic 326-20? |
|---|---|
| been breached, it can require Bank to repurchase the loan. | |
| **Default call option (held by transferor)** | |
| Bank has an option to repurchase a loan if the borrower defaults. | No. Although this arrangement is triggered by a credit-related event, we believe it is not in the scope of Subtopic 326-20 because the arrangement to repurchase the defaulted loan is at Bank's sole discretion. |
| **Default put option (held by transferee)** | |
| Bank provides the transferee with an option to require Bank to repurchase a loan if the borrower defaults. | Yes. This arrangement is triggered by a credit-related event (i.e. borrower default) and is unilaterally exercisable by the transferee (i.e. not in Bank's control). As a result, we believe the arrangement is in the scope of Subtopic 326-20. Further, such an arrangement represents a financial guarantee under Topic 460 (see chapter 14).<br>For an illustration of the accounting for a default put option, see Example 14.4.10. |
| Note:<br>1. Standard representations and warranties are those that assert that the financial asset being transferred is what it is purported to be at the transfer date. [860-10 Glossary] | |

## **Question 2.2.100** Are indemnification assets arising from business combinations in the scope of Subtopic 326-20?

### Excerpt from ASC 805-20

• > Indemnification Assets

**25-27** The seller in a business combination may contractually indemnify the acquirer for the outcome of a contingency or uncertainty related to all or part of a specific asset or liability. For example, the seller may indemnify the acquirer against losses above a specified amount on a liability arising from a particular contingency; in other words, the seller will guarantee that the acquirer's liability will not exceed a specified amount. As a result, the acquirer obtains an indemnification asset. The acquirer shall recognize an indemnification asset at the same time that it recognizes the indemnified item, measured on the same basis as the indemnified item, subject to the need for a valuation allowance for uncollectible amounts. Therefore, if the indemnification relates to an asset or a liability that is recognized at the acquisition date and measured at its

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

acquisition-date fair value, the acquirer shall recognize the indemnification asset at the acquisition date measured at its acquisition-date fair value.

**35-4** At each subsequent reporting date, the acquirer shall measure an indemnification asset that was recognized in accordance with paragraphs 805-20-25-27 through 25-28 at the **acquisition date** on the same basis as the indemnified liability or asset, subject to any contractual limitations on its amount, except as noted in paragraph 805-20-35-4B, and, for an indemnification asset that is not subsequently measured at its fair value, management's assessment of the collectibility of the indemnification asset.

**Background:** Topic 805 requires a valuation allowance for uncollectible amounts to be created for an indemnification asset arising from a business combination but does not specify what guidance should be applied to measure the allowance. [805-20-25-27]

**Interpretive response:** It depends. We believe indemnification assets are in the scope of Subtopic 326-20 only when the indemnified item is a financial asset measured at amortized cost.

This is because Subtopic 326-20 applies to financial assets measured at amortized cost. Indemnification assets are measured on the same basis as the indemnified item. Therefore, they are not measured based on amortized cost unless the indemnified item is a financial asset measured at amortized cost.

For further discussion of the accounting for indemnification assets in business combinations, see paragraphs 7.168 – 7.173a of KPMG Handbook, Business combinations.

## **Question 2.2.110** Are guarantees between entities under common control that relate to a third-party credit exposure in the scope of Subtopic 326-20?

**Interpretive response:** Yes. Subtopic 326-20 does not specifically address guarantees between entities under common control. However, we believe such guarantees are in the scope of Subtopic 326-20 if they relate to third-party credit exposure.

Financial guarantees that are off-balance sheet credit exposures are in the scope of Subtopic 326-20 if they are not accounted for as insurance contracts or derivatives. Conversely, loans and receivables between entities under common control are not in scope. However, this scope exception relates to credit exposure to another entity in a common control group. A guarantee between common control entities that relates to a third-party credit exposure is significantly different. Therefore, we believe Subtopic 326-20 applies to common control guarantees that relate to a third-party credit exposure. [326-10-15-3, 326-20-15-2(c)]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Example 2.2.20** Accounting for guarantees between entities under common control that relates to third-party credit exposure

Subsidiary A and Subsidiary B are wholly owned consolidated subsidiaries of Parent, which makes them entities under common control. Parent issues consolidated financial statements and Subsidiary A and Subsidiary B issue stand-alone financial statements.

Subsidiary A makes a loan to an unrelated third-party entity. Subsidiary B (guarantor) guarantees this loan such that if the third-party borrower fails to repay, Subsidiary B will reimburse Subsidiary A. The guarantee is not accounted for as a derivative.

Subsidiary B estimates credit losses for the guarantee for purposes of its stand-alone financial statements because the guarantee is an off-balance sheet credit exposure in the scope of Subtopic 326-20.

## 2.3 Explicit scope exclusions

### 2.3.10 Overview

#### Excerpt from ASC 326-20

> Instruments

**15-3** The guidance in this Subtopic does not apply to the following items:

a. Financial assets measured at **fair value** through net income
b. Available-for-sale debt securities
c. **Loans** made to participants by defined contribution employee benefit plans
d. Policy loan receivables of an insurance entity
e. Promises to give (pledges receivable) of a not-for-profit entity
f. Loans and receivables between entities under common control.
g. Receivables arising from operating leases accounted for in accordance with Topic 842.

The following are observations about the explicit scope exclusions from Subtopic 326-20. [326-20-15-3]

| Scope exclusions | Observations |
|---|---|
| **Financial assets measured at fair value through net income** | These financial assets are not evaluated for impairment because they are measured at fair value with changes in fair value reported in net income. |
| **AFS debt securities** | AFS debt securities are accounted for under Subtopic 326-30 (see chapter 19) rather than Subtopic 326-20. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Scope exclusions | Observations |
|---|---|
| **Loans made to participants by defined contribution employee benefit plans** | Subtopic 962-310 provides industry-specific guidance for these loans. |
| **Policy loan receivables of an insurance entity** | Topic 944 provides industry-specific guidance for insurance entities. |
| **Pledge receivables of a not-for-profit entity** | Subtopics 958-310 and 958-605 provide industry-specific not-for-profit entity guidance for contributions of cash and other assets received, including promises to give. |
| **Loans and receivables between entities under common control** | Loans and receivables between entities under common control are excluded from the scope of Subtopic 326-20. This was in response to concerns raised by the Private Company Council that some related party loans may be viewed as capital contributions rather than loans to be repaid. [ASU 2016-13.BC31]<br>Loans and receivables between related parties – other than those in common control situations – are in the scope of Subtopic 326-20. |
| **Receivables arising from operating leases** | Receivables arising from operating leases are excluded from the scope of Subtopic 326-20. This is because Topic 842 has measurement guidance for operating lease receivables, including when collectibility is not probable. [ASU 2018-19.BC13] |

In addition to the specific scope exclusions, servicing rights are also not in the scope of Subtopic 326-20 because they are nonfinancial assets or liabilities. Servicing rights are subsequently measured at fair value or under the amortization method. Under the amortization method, impairment on servicing assets is recognized through a valuation account at an amount by which the carrying amount for a stratum exceeds its fair value. [860-50-35]

## **Question 2.3.10** Is there a difference in the timing and amount of credit losses when a debt security is classified as HTM rather than AFS?

**Interpretive response:** Under Topic 326, there may be significant differences in the timing and amount of credit losses recognized for debt securities classified as HTM (Subtopic 326-20 applies) versus AFS (Subtopic 326-30 applies).

Credit losses for a security classified as HTM will generally be recognized earlier than if the security is classified as AFS. This is because lifetime expected credit losses are recognized for HTM securities upon purchase, while credit losses for

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

AFS debt securities are recognized only once they have occurred. [326-20-30, 326-30-35]

## **Question 2.3.20** When does the scope exclusion for loans and receivables between entities under common control apply?

**Interpretive response:** The term 'common control' is not defined in the Master Glossary and it is applied in multiple contexts throughout the Codification. In finalizing its 2015 amendments to the consolidation analysis in Topic 810 (consolidation), the FASB noted that its intent was for the term in the context of Topic 810 "to include subsidiaries controlled (directly or indirectly) by a common parent, or a subsidiary and its parent." We believe this guidance applies under Subtopic 326-20. [ASU 2015-02.BC69]

Additionally, although a consensus was not reached on EITF Issue No. 02-5 regarding business combinations, we believe that an entity should also consider the discussion related to that EITF Issue.

In particular, the SEC staff indicated in EITF 02-5 that common control also exists among separate entities in the following circumstances:

- Immediate family members collectively hold a controlling financial interest in each entity, and there is no evidence that those family members will exercise their decision-making rights in any way other than in concert.
- A group of shareholders holds a controlling financial interest in each entity, and contemporaneous written evidence of an agreement to exercise their decision-making rights in concert exists.

## **Question 2.3.30** Are assets that arise from recognizing lease income on a straight-line basis in the scope of Subtopic 326-20?

**Background:** In an operating lease, the lessor recognizes lease income on a straight-line basis unless another systematic and rational basis is more representative of the pattern in which income is earned from the underlying asset. If the lease payments escalate over the lease term, the lessor recognizes an accrued rent asset in the periods that lease income exceeds the contractual rent payment. The asset is eliminated in later periods when the opposite is true. [842-30-25-11]

**Interpretive response:** No. We believe assets that arise from recognizing lease income on a straight-line (or other systematic and rational) basis are not financial assets. As a result, they are excluded from the scope of Subtopic 326-20.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 3. Recognition of expected credit losses, writeoffs and recoveries

## Detailed contents

**3.1 How the standard works**

**3.2 Recognition of allowance for credit losses**

3.2.10 Overview

3.2.20 Considerations for loans transferred between categories

**Questions**

**Question 3.2.10** Is there a recognition threshold for credit impairment under Subtopic 326-20?

**Question 3.2.20** [Not used]

**Question 3.2.25** How does a transferor account for the allowance for credit losses associated with a transfer of financial assets accounted for as a sale?

**Question 3.2.30** Are the effects of a transfer between categories reported on a gross or net basis?

**Question 3.2.40** Does an entity recognize a writeoff when a loan is transferred from held-for-investment to held-for-sale?

**Examples**

**Example 3.2.05** Sale of a group of entire financial assets

**Example 3.2.10** [Not used]

**Example 3.2.20** Transferring a financial asset from held-for-investment to held-for-sale

**3.3 Recognition of writeoffs and recoveries**

3.3.10 Overview

**Question**

**Question 3.3.10** Does an entity include contractual interest in its estimate of expected recoveries?

**Example**

**Example 3.3.10** Effect of expected recoveries on allowance for credit losses

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 3.1 How the standard works

Subtopic 326-20 requires lifetime expected credit losses of a financial asset to be recognized when the asset is purchased or originated. Credit losses are recognized using an allowance approach, with subsequent changes in expected credit losses (favorable and unfavorable) recognized immediately in net income by adjusting the allowance.

Subtopic 326-20 requires an entity to write off financial assets that it deems uncollectible. When estimating lifetime expected credit losses, an entity considers expected recoveries of amounts previously written off and expected to be written off. In limited circumstances, this may result in the allowance for credit losses being negative.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 3.2 Recognition of allowance for credit losses

## 3.2.10 Overview

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-1** 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. Expected recoveries of amounts previously written off and expected to be written off shall be included in the valuation account and shall not exceed the aggregate of amounts previously written off and expected to be written off by an entity. At the reporting date, an entity shall record an allowance for credit losses on financial assets within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s).

> Reporting Changes in Expected Credit Losses

**35-1** At each reporting date, an entity shall record an allowance for credit losses on **financial assets** (including **purchased financial assets with credit deterioration**) within the scope of this Subtopic. An entity shall compare its current estimate of expected credit losses with the estimate of expected credit losses previously recorded. An entity shall report in net income (as a credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s). The method applied to initially measure expected credit losses for the assets included in paragraph 326-20-30-14 generally would be applied consistently over time and shall faithfully estimate expected credit losses for financial asset(s).

On initial recognition and at each reporting date, an entity recognizes an allowance for remaining lifetime expected credit losses. The allowance is deducted from the amortized cost basis of a financial asset or a group of financial assets so that the balance sheet reflects the net amount an entity expects to collect. Subsequent changes (favorable and unfavorable) in expected credit losses are recognized immediately in net income as a credit loss expense or a reversal of credit loss expense. See chapter 23 for presentation guidance. [326-20-30-1, 35-1]

### **Question 3.2.10** Is there a recognition threshold for credit impairment under Subtopic 326-20?

**Interpretive response:** No. Recognition of credit impairment is no longer based on a recognition threshold such as the probability threshold in legacy US GAAP, under which an impairment loss for a loan was not recognized until the loss was probable of being incurred. Removing this threshold results in earlier

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

recognition of expected credit losses because all losses expected over an asset's life are recorded before they are probable of occurring – even if the likelihood of a loss is remote. [310-10-35-4, 450-20-25-2(a)]

Because of the lack of a recognition threshold, an allowance for credit losses – and the related credit loss expense recognized in net income – is generally recognized at the first reporting date following the purchase or origination of a financial asset. This has the practical effect of recognizing a Day 1 loss in net income when an entity originates a financial asset or purchases a non-credit deteriorated financial asset that is in the scope of Subtopic 326-20. Purchased financial assets with credit deterioration (PCD) are accounted for differently, as discussed in chapter 12. [ASU 2016-13.BC48]

Further, Day 1 losses will likely result in changes in the volume of loan originations or purchases of non-credit deteriorated loans and HTM debt securities, thereby affecting the comparisons of an entity's earnings measures between periods and/or with other entities.

## **Question 3.2.25** How does a transferor account for the allowance for credit losses associated with a transfer of financial assets accounted for as a sale?

**Background:** In a transfer of financial assets accounted for as a sale, a transferor: [860-20-40-1A - 40-1B]

- derecognizes the financial asset;
- recognizes assets obtained and liabilities incurred (net proceeds) in the sale at fair value; and
- recognizes any gain or loss in earnings, calculated as the difference between the net proceeds received and the carrying amounts of the financial assets derecognized.

Chapter 7 of KPMG Handbook, Transfers and servicing of financial assets, includes guidance on the accounting for transfers of financial assets that qualify as a sale.

**Interpretive response:** A loan classified as held-for-investment is reclassified to held-for-sale when an entity decides to sell a loan. Therefore, when an entity decides to sell a financial asset in a transfer accounted for as a sale, it first applies the guidance on transfers from held-for-investment to held-for-sale. Therefore, an entity:

- reverses in earnings any allowance for credit losses previously recorded on the loan;
- reclassifies and transfers the loan into the held-for-sale classification at its amortized cost basis; and
- determines whether a valuation allowance is necessary by following the guidance in Subtopic 310-10 or 948-310, as applicable.

Therefore, the allowance for credit losses does not impact the gain or loss on sale amount recognized in earnings. [310-10-35-48A, 948-310-35-2A]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 3.2.05** Sale of a group of entire financial assets

ABC Corp. holds a group of trade receivables that are classified as held-for-investment. ABC decides to sell trade receivables with an unpaid principal balance of $100,000. Accordingly, it reclassifies the trade receivables to held-for-sale. Based on its policy, ABC determines that the receivables were not uncollectible and did not have significant credit deterioration.

ABC transfers the receivables to an unconsolidated securitization entity for $98,000 in cash and a beneficial interest in the securitization trust. ABC continues to service the transferred receivables.

The $100,000 of receivables have unamortized deferred origination costs (net) of $5,000 resulting in a carrying amount of $105,000. The allowance for credit losses is $1,500.

ABC determines that the fair values of the beneficial interest and servicing asset are $10,000 and $2,000, respectively.

ABC determines that the transfer meets the criteria to be accounted for as a sale. It calculates the gain on the sale of the receivables as follows.

| **Fair value of assets obtained in the sale (and calculation of net proceeds)** | |
|---|---|
| Cash | 98,000 |
| Beneficial interest | 10,000 |
| Servicing asset | 2,000 |
| Fair value of assets obtained (net proceeds) | 110,000 |

| **Calculation of the gain (loss) on sale** | |
|---|---|
| Fair value of assets obtained in the sale (net proceeds) | 110,000 |
| Less: Carrying amount of transferred receivables | (105,000) |
| Gain on sale of receivables | 5,000 |

ABC records the following journal entries to account for the transfer from held-for-investment to held-for-sale.

| | **Debit** | **Credit** |
|---|---|---|
| Allowance for credit losses | 1,500 | |
| Credit loss expense | | 1,500 |
| *To reverse existing allowance for credit losses on held-for-investment receivables.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Receivables – held-for-sale | 100,000 | |
| Deferred origination costs (net) – held-for-sale | 5,000 | |
| Receivables – held-for-investment | | 100,000 |
| Deferred origination costs (net) – held-for-investment | | 5,000 |
| *To record transfer of receivables from held-for-investment to held-for-sale.* | | |

ABC records the following journal entry to account for the transfer of these receivables to an unconsolidated securitization entity.

| | Debit | Credit |
|---|---|---|
| Cash | 98,000 | |
| Beneficial interest | 10,000 | |
| Servicing asset | 2,000 | |
| Receivables – held-for-sale | | 100,000 |
| Deferred origination costs (net) – held for sale | | 5,000 |
| Gain on sale | | 5,000 |
| *To derecognize carrying amount of assets sold, recognize fair value of assets obtained and recognize gain on sale.* | | |

## 3.2.20 Considerations for loans transferred between categories

### Excerpt from ASC 326-20

> Loans Subsequently Identified for Sale

**35-7** Once a decision has been made to sell **loans** not currently classified as held for sale, those loans shall be transferred into the held-for-sale classification. See paragraph 310-10-35-48A for guidance on transfers of nonmortgage loans between classifications and see Topic 948 for guidance on transfers of mortgage loans between classifications. The application of the writeoff guidance in paragraph 326-20-35-8 may result in a portion of the amortized cost basis being written off before the loan has been transferred to the held-for-sale classification.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Excerpt from ASC 310-10

• > Transfers of Nonmortgage Loans between Classifications

**35-48A** For a nonmortgage loan that is transferred into the held-for-sale classification from the nonmortgage loan not-held-for-sale classification, an entity shall reverse in earnings any allowance for credit losses previously recorded on the nonmortgage loan not held for sale at the transfer date. An entity shall then reclassify and transfer the nonmortgage loan into the held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses). An entity shall then determine if a valuation allowance is necessary by following the guidance in Subtopic 310-10.

**35-48B** For a nonmortgage loan that is transferred into the not-held-for-sale classification from the nonmortgage loans held-for-sale classification, an entity shall reverse in earnings any valuation allowance previously recorded on the nonmortgage loan held for sale at the transfer date. An entity shall then reclassify and transfer the nonmortgage loan into the not-held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any valuation allowance). An entity shall then determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-20.

> Nonmortgage Loans or Trade Receivables

**45-2** Nonmortgage loans or trade receivables may be presented on the balance sheet as aggregate amounts. However, such receivables held for sale shall be a separate balance sheet category. Major categories of nonmortgage loans or trade receivables shall be presented separately either in the balance sheet or in the notes to financial statements. An entity shall present the amounts reversed or established for the valuation allowance and the allowance for credit losses, as applicable, related to the transfer of nonmortgage loans (see paragraphs 310-10-35-48A through 35-48B) on a gross basis in the income statement. An entity may present those amounts on the income statement or in the notes to financial statements.

## Excerpt from ASC 948-310

> Loans Held for Sale

**35-2A** For a mortgage loan that is transferred into the held-for-sale classification from the held-for-long-term-investment classification, an entity shall reverse in earnings any allowance for credit losses previously recorded on the mortgage loan held-for-long-term-investment at the transfer date. An entity shall then reclassify and transfer the mortgage loan into the held-for-sale classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any allowance for credit losses). An entity shall then determine if a valuation allowance is necessary by following the applicable guidance in this Subtopic.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

> Loans Held as Long-Term Investments

**35-5A** For a mortgage loan that is transferred into the held-for-long-term-investment classification from the mortgage loans held-for-sale classification, an entity shall reverse in earnings any valuation allowance previously recorded on the mortgage loan held for sale at the transfer date. An entity shall then reclassify and transfer the mortgage loan into the held-for-long-term-investment classification at its amortized cost basis (which is reduced by any previous writeoffs but excludes any valuation allowance). An entity shall then determine if an allowance for credit losses is necessary by following the guidance in Subtopic 326-20.

**General**

**45-2** An entity shall present the amounts reversed or established for the valuation allowance and the allowance for credit losses, as applicable, related to the transfer of a mortgage loan between classifications (see paragraphs 948-310-35-2A and 948-310-35-5A) on a gross basis in the income statement. An entity may present those amounts on the income statement or in the notes to financial statements.

Specific considerations apply when loans are transferred between the held-for-investment and held-for-sale categories (or when debt securities are transferred between the HTM and AFS categories). This chapter discusses transfers of loans between categories. For transfers of debt securities between categories, see section 4.4 of KPMG Handbook, Investments.

| Loans | |
|---|---|
| **Transfer from held-for-investment to held-for-sale** | **Transfer from held-for-sale to held-for-investment** |
| • Reverse in earnings any allowance for credit losses previously recorded on the loan.<br>• Reclassify and transfer the loan into the held-for-sale classification at its amortized cost basis.[1]<br>• Determine whether a valuation allowance is necessary by following the guidance in Subtopic 310-10 or 948-310, as applicable.<br>[310-10-35-48A, 948-310-35-2A] | • Reverse in earnings any valuation allowance previously recorded on the loan.<br>• Reclassify and transfer the loan into the held-for-investment classification at its amortized cost basis.[1]<br>• Determine whether an allowance for credit losses is necessary by following the guidance in Subtopic 326-20.<br>[310-10-35-48B, 948-310-35-5A] |
| Note:<br>1. The amortized cost basis that is transferred is reduced by any previous writeoffs, but excludes any valuation allowance or allowance for credit losses, as applicable. | |

## Question 3.2.30 Are the effects of a transfer between categories reported on a gross or net basis?

**Interpretive response:** An entity presents the amounts reversed or established for a valuation allowance or allowance for credit losses, as applicable, on a

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

gross basis in the income statement or in the notes to the financial statements. [310-10-45-2, 948-310-45-2]

## **Question 3.2.40** Does an entity recognize a writeoff when a loan is transferred from held-for-investment to held-for-sale?

**Interpretive response**: It depends. We believe the accounting for the loan and associated allowance depends on the credit quality of the loan when an entity changes its intent.

When an entity changes its intent, it reclassifies and transfers a loan into the held-for-sale category at the loan's amortized cost basis, which is reduced by any previous writeoffs, but excludes any allowance for credit losses. Therefore, an entity applies its writeoff policy before transferring a loan to held-for-sale. The portion of the allowance that does not relate to the amount written off is reversed in earnings upon transfer. [310-10-35-48A, 948-310-35-2(a)]

As noted in Question 4.2.35, if an entity expects to sell a loan with significant credit deterioration, it incorporates its estimate of future losses from the expected sale when estimating expected credit losses. Therefore, the allowance for credit losses reflects the full amount of the expected loss on sale.

When the specific loan is identified and ultimately transferred to the held-for-sale category, we believe the portion of the loan's carrying amount that exceeds its fair value should be deemed uncollectible. Therefore, it should be written off against the associated allowance for credit losses at the time of transfer.

In contrast, when a loan does not have significant credit deterioration – and therefore the allowance does not include an estimate of the expected loss on sale – we believe a writeoff generally should not be recognized when the loan is transferred. An exception arises when the writeoff relates to an aspect of the entity's writeoff policy that is unrelated to the intent to sell the loan, such as the number of days that the loan has been delinquent.

## **Example 3.2.20** Transferring a financial asset from held-for-investment to held-for-sale

ABC Corp. changes its intent and decides to transfer a loan from held-for-investment to held-for-sale on January 1, Year 2. Before changing its intent on January 1, Year 2, ABC had the intent and ability to hold the loan for the foreseeable future.

On December 31, Year 1 (immediately before this transfer), the loan has:

- an amortized cost basis of $100
- a previously recorded allowance for credit losses of $2
- a fair value of $95.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

***Scenario 1: Loan does not have significant credit deterioration based on ABC's policy***

Because the loan does not have significant credit deterioration based on ABC's accounting policy, ABC records the following journal entries upon transfer.

| | Debit | Credit |
|---|---|---|
| Allowance for credit losses | 2 | |
| Provision for credit losses | | 2 |
| *To reverse existing allowance for credit losses on held-for-investment loan.* | | |
| Loans held-for-sale | 100 | |
| Loans held-for-investment | | 100 |
| *To record transfer of the loan from held-for-investment to held-for-sale.* | | |
| Loss on loans held-for-sale | 5 | |
| Valuation allowance (loans held for sale)[1] | | 5 |
| *To establish valuation allowance under Subtopic 310-10.* | | |

Note:
1. The valuation allowance is the difference between the amortized cost basis ($100) and fair value ($95).

***Scenario 2: Loan is considered to have significant credit deterioration based on ABC's policy***

Because the loan has significant credit deterioration based on ABC's accounting policy, ABC records the following journal entry when it changes its intent.

| | Debit | Credit |
|---|---|---|
| Provision for credit losses | 3 | |
| Allowance for credit losses[1] | | 3 |
| *To record increase in allowance for credit losses to reflect full amount of expected loss on sale.* | | |

Note:
1. The valuation allowance is the difference between the amortized cost basis ($100) and fair value ($95).

ABC records the following journal entries upon transfer.

| | Debit | Credit |
|---|---|---|
| Allowance for credit losses | 5 | |
| Loans held for investment | | 5 |
| *To record writeoff of portion of carrying amount of loan that exceeds fair value (uncollectible portion) and associated allowance.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Loans held for sale | 95 | |
| Loans held for investment | | 95 |
| *To record transfer of loan from held-for-investment to held-for-sale.* | | |

## 3.3 Recognition of writeoffs and recoveries

### 3.3.10 Overview

**Excerpt from ASC 326-20**

> Writeoffs of Financial Assets

**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.

For financial assets measured at amortized cost, an entity is required to: [326-20-30-1, 35-8]

- deduct (or add) the allowance for credit losses from (to) the amortized cost of financial assets to present the net amount expected to be collected on the financial assets; and
- recognize writeoffs (full or partial) of financial assets in the period in which they are deemed uncollectible.

The allowance for credit losses is required to include expected recoveries of amounts previously written off and expected to be written off. Considering recoveries of previously charged-off financial assets in the estimate of expected credit losses may, in limited circumstances, result in the allowance for credit losses being negative (i.e. a debit balance). The negative allowance for credit losses may not exceed amounts previously written off (or expected to be written off). [326-20-30-1]

Additional guidance applies to the following.

- Collateral dependent financial assets, including that a negative allowance for credit losses may result when the practical expedient is applied. See section 10.2 for further discussion.
- PCD assets, including that when a method other than a discounted cash flow method is used to estimate credit losses, expected recoveries do not include any amounts that result in an acceleration of the non-credit discount. See section 12.4.20 for further discussion.

The writeoff of an asset is generally recognized as a reduction from the allowance for credit losses. However, the FASB has provided additional flexibility for writeoffs of accrued interest receivable on financial assets carried

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

at amortized cost. See further discussion in Questions 4.2.50 and 19.6.30. [326-20-35-8 – 35-8A, 326-30-35-13A]

## Question 3.3.10 Does an entity include contractual interest in its estimate of expected recoveries?

**Interpretive response:** No, not unless it was accrued prior to the asset being written off.

A negative allowance for credit losses is limited to amounts previously written off and expected to be written off. Contractual interest that has not been accrued has not been written off. As a result, it is not included in an entity's estimate of expected recoveries. [326-20-30-1]

## Example 3.3.10 Effect of expected recoveries on allowance for credit losses

Bank is measuring its allowance for credit losses at the end of Year 2 for a portfolio of financial assets measured at amortized cost. Its portfolio includes the following:

- loans for which no amounts have been written off;
- a loan for which a partial writeoff has been recognized; and
- loans that have been fully written off.

***Loans with no amounts written off***

Bank estimates that it will write off 4% of these loans, excluding the effects of expected recoveries of amounts expected to be written off. Bank's expected recovery rate related to amounts expected to be written off is 20%.

Bank estimates expected credit losses on these loans as follows.

| | |
|---|---|
| Amortized cost of loan portfolio not written off | 100,000,000 |
| Expected gross loss rate | 4% |
| Expected credit losses, excluding expected recoveries[1] | 4,000,000 |
| Expected recovery rate | (20%) |
| Expected recoveries [of amounts expected to be written off][2] | (800,000) |
| Expected credit losses, net[3] | 3,200,000 |

Notes:

1. Amortized cost of loan portfolio not written off × Expected gross loss rate.
2. Expected credit losses, excluding expected recoveries × Expected recovery rate.
3. Expected credit losses, excluding expected recoveries + Expected recoveries.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### *Loan partially written off*

During Year 2, Bank writes off $3.75 million of a loan that had an amortized cost of $5 million – i.e. the loan had a remaining amortized cost of $1.25 million at the end of Year 2. At the end of Year 2, Bank expects to collect $1.5 million related to the loan.

Bank estimates expected credit losses on this loan as follows.

| | |
|---|---|
| Amount Bank expects to collect | 1,500,000 |
| Amortized cost at end of Year 2 | 1,250,000 |
| Expected credit losses (recoveries), net[1] | (250,000) |

Note:

1. The negative allowance is $0.25 million, which is less than the limit of the amount previously written off ($3.75 million).

### *Loans fully written off*

Bank fully wrote off $3 million of loans in each of Year 1 and Year 2. Bank's expected recovery rate related to amounts fully written off is 20%.

For simplicity, this example assumes that Bank:

- does not expect to recover any amounts on loans written off before Year 1; and
- has not yet received any recoveries of amounts written off in either Year 1 or Year 2.

Bank estimates expected recoveries on these loans as follows.

| | |
|---|---|
| Amortized cost of loans fully written off[1] | 6,000,000 |
| Expected recovery rate | 20% |
| Expected recoveries[2] | 1,200,000 |

Notes:

1. $3 million written off in each of Year 1 and Year 2.
2. Amortized cost of loans written off × Expected recovery rate; the negative allowance is $1.2 million, which is less than the limit of the amount previously written off ($6 million).

### *Allowance for credit losses*

Bank's allowance for credit losses is summarized as follows.

| | |
|---|---|
| Loans with no amounts written off – Expected credit losses (including expected recoveries of amounts expected to be written off) | 3,200,000 |
| Loans partially written off – Expected recoveries of amounts previously written off | (250,000) |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| Loans fully written off – Expected recoveries of amounts previously written off | (1,200,000) |
| Total | 1,750,000 |

## Excerpt from ASC 326-20

• > Example 9: Recognizing Writeoffs and Recoveries

**55-51** This Example illustrates how an entity may implement the guidance in paragraphs 326-20-35-8 through 35-9 relating to writeoffs and recoveries of expected credit losses on financial assets.

**55-52** Bank K currently evaluates its loan to Entity L on an individual basis because Entity L is 90 days past due on its loan payments and the loan no longer exhibits similar risk characteristics with other loans in the portfolio. At the end of December 31, 20X3, the amortized cost basis for Entity L's loan is $500,000 with an allowance for credit losses of $375,000. During the first quarter of 20X4, Entity L issues a press release stating that it is filing for bankruptcy. Bank K determines that the $500,000 loan made to Entity L is uncollectible. Bank K considers all available information that is relevant and reasonably available, without undue cost or effort, and determines that the information does not support an expectation of a future recovery in accordance with paragraph 326-20-30-7. Bank K measures a full credit loss on the loan to Entity L and writes off its entire loan balance in accordance with paragraph 326-20-35-8, as follows.

| | | |
|---|---|---|
| Credit loss expense | $125,000 | |
| Allowance for credit losses | | $125,000 |
| Allowance for credit losses | $500,000 | |
| Loan receivable | | $500,000 |

During March 20X6, Bank K receives a partial payment of $50,000 from Entity L for the loan previously written off. Upon receipt of the payment, Bank K recognizes the recovery in accordance with paragraph 326-20-35-8, as follows:

| | | |
|---|---|---|
| Cash | $50,000 | |
| Allowance for credit losses (recovery) | | $50,000 |

**55-53** For its March 31, 20X6 financial statements, Bank K estimates expected credit losses on its financial assets and determines that the current estimate is consistent with the estimate at the end of the previous reporting period. During the period, Bank K does not record any change to its allowance for credit losses account other than the recovery of the loan to Entity L. To adjust its allowance for credit losses to reflect the current estimate, Bank K reports the following on March 31, 20X6:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | | |
|---|---|---|
| Allowance for credit losses | $50,000 | |
| Credit loss expense | | $50,000 |

Alternatively, Bank K could record the recovery of $50,000 directly as a reduction to credit loss expense, rather than initially recording the cash received against the allowance.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 4. Methods to estimate expected credit losses

## Detailed contents

**4.1 How the standard works**

**4.2 Estimating expected credit losses**

4.2.10 Overview

4.2.20 Accrued interest receivable

**Questions**

**Question 4.2.10** Does Subtopic 326-20 provide specific guidance on how to estimate expected credit losses?

**Question 4.2.20** [Not used]

**Question 4.2.25** Are expected losses associated with risks other than credit risk included in the estimate of expected credit losses?

**Question 4.2.30** Are anticipated costs associated with loss mitigation and/or potential future declines in collateral values included in the estimate of expected credit losses?

**Question 4.2.35** How are expected sales of loans considered when estimating expected credit losses?

**Question 4.2.40** What time period for writing off accrued interest receivable is considered 'timely'?

**Question 4.2.50** Must an entity write off accrued interest receivable as a deduction from the allowance for credit losses?

**4.3 Methods other than discounted cash flow methods**

4.3.10 Overview

**Questions**

**Question 4.3.10** May an entity estimate lifetime expected credit losses by multiplying an average annual loss rate by the financial asset's remaining contractual term?

**Question 4.3.20** Can an entity discount cash flows when applying a method other than a discounted cash flow method?

**Question 4.3.30** Does an entity reserve for future interest when applying a method other than a discounted cash flow method to estimate expected credit losses?

**Question 4.3.40** What effect do unamortized premiums and discounts have on the estimate of expected credit losses?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 4.3.50** Must an entity accumulate new data if it measures the components of the amortized cost separately?

**Examples**

**Example 4.3.10** Applying the combined approach

**Example 4.3.20** Applying the separate approach

## 4.4 Discounted cash flow method

4.4.10 Overview

4.4.20 Calculating the EIR

4.4.30 Calculating the EIR – Prepayment considerations

4.4.40 Calculating the EIR – Variable rate loan considerations

**Questions**

**Question 4.4.10** When a discounted cash flow method is used, at what date should cash flows from expected recoveries be included?

**Question 4.4.20** When a discounted cash flow method is used, at what date are amounts from expected foreclosed assets included?

**Question 4.4.25** Can an entity estimate expected credit losses by discounting expected losses?

**Question 4.4.30** How is the EIR calculated under Subtopic 326-20?

**Question 4.4.40** Is the EIR recalculated when a financial asset's amortized cost basis changes?

**Question 4.4.50** How is the prepayment-adjusted EIR determined?

**Question 4.4.60** Why would an entity elect to use a prepayment-adjusted EIR to discount cash flows?

**Question 4.4.70** [Not used]

**Question 4.4.80** How is the EIR calculated under Subtopic 326-20 for a variable rate loan?

**Examples**

**Example 4.4.05** Discounting expected losses

**Example 4.4.10** Discounted cash flow method – changes in EIR due to additional costs

**Example 4.4.20** Effect of using a prepayment-adjusted EIR

**Example 4.4.30** EIR used to calculate the allowance for credit losses – variable rate loan

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 4.1 How the standard works

Subtopic 326-20 does not prescribe all aspects of the expected credit loss estimate, including the specific method to be used. However, it describes how an entity should estimate expected credit losses based on the type of method used.

| Method | Allowance calculation |
|---|---|
| **Discounted cash flow method** | The allowance for credit losses reflects the difference between:<br>• the amortized cost basis; and<br>• the present value of the principal and interest cash flows expected to be collected. |
| **Other methods** | The allowance for credit losses reflects the entity's expected credit losses of the amortized cost basis. |

Subtopic 326-20 provides additional guidance on estimating expected credit losses for certain financial instruments, including but not limited to, purchased financial assets with credit deterioration (chapter 12), off-balance sheet credit exposures (see chapter 13), collateral-dependent financial assets (see chapter 10) and net investments in leases (see chapter 16).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 4.2 Estimating expected credit losses

## 4.2.10 Overview

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-3** The allowance for credit losses may be determined using various methods. For example, an entity may use discounted cash flow methods, loss-rate methods, roll-rate methods, probability-of-default methods, or methods that utilize an aging schedule. An entity is not required to utilize a discounted cash flow method to estimate expected credit losses. Similarly, an entity is not required to reconcile the estimation technique it uses with a discounted cash flow method.

• > Developing an Estimate of Expected Credit Losses

**55-6** Estimating expected credit losses is highly judgmental and generally will require an entity to make specific judgments. Those judgments may include any of the following:

a. The definition of default for default-based statistics
b. The approach to measuring the historical loss amount for loss-rate statistics, including whether the amount is simply based on the amortized cost amount written off and whether there should be adjustments to historical credit losses (if any) to reflect the entity's policies for recognizing accrued interest
c. The approach to determine the appropriate historical period for estimating expected credit loss statistics
d. The approach to adjusting historical credit loss information to reflect current conditions and reasonable and supportable forecasts that are different from conditions existing in the historical period
e. The methods of utilizing historical experience
f. The method of adjusting loss statistics for recoveries
g. How expected prepayments affect the estimate of expected credit losses
h. How the entity plans to revert to historical credit loss information for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses
i. The assessment of whether a financial asset exhibits risk characteristics similar to other financial assets.

**55-7** Because of the subjective nature of the estimate, this Subtopic does not require specific approaches when developing the estimate of expected credit losses. Rather, an entity should use judgment to develop estimation techniques that are applied consistently over time and should faithfully estimate the collectibility of the financial assets by applying the principles in this Subtopic. An entity should utilize estimation techniques that are practical and relevant to the circumstance. The method(s) used to estimate expected credit losses may vary on the basis of the type of financial asset, the entity's ability to predict the timing of cash flows, and the information available to the entity.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Subtopic 326-20 does not prescribe a specific method for estimating expected credit losses. Rather, given the subjective nature of the estimate, the FASB decided that an entity should use judgment to develop an approach that faithfully reflects expected credit losses for financial assets and can be applied consistently over time.

Examples of methods that may be used to estimate expected credit losses include: [326-20-30-3, 55-6, 55-7]

- discounted cash flow method;
- probability of default and loss given default methods;
- loss-rate and roll-rate methods; and
- methods that use an aging schedule.

The amortized cost is the amount for which a receivable or investment is originated or acquired, adjusted for accrued interest, accretion or amortization of premiums, discounts, and net deferred fees or costs, collection of cash, writeoffs, foreign exchange, and fair value hedge accounting adjustments. Although the amortized cost includes accrued interest, an entity that writes off accrued interest receivable in a timely manner is permitted to elect not to measure an allowance for credit losses on accrued interest (see section 4.2.20). [326-20 Glossary, 326-20-30-5]

## **Question 4.2.10** Does Subtopic 326-20 provide specific guidance on how to estimate expected credit losses?

**Interpretive response:** Subtopic 326-20 requires an entity to recognize lifetime expected credit losses but does not prescribe certain aspects of the expected credit loss estimate, including:

- the specific method to be used, including whether to apply a discounted cash flow method;
- how to determine the reasonable and supportable forecast period;
- how to revert to historical losses beyond the reasonable and supportable forecast period;
- how to determine historical losses; and
- how to determine forecasted future credit losses.

Therefore, Subtopic 326-20 allows various approaches. See chapter 7 regarding historical losses and forecasts. [326-20-55-6]

Different approaches may lead to diversity in practice and ranges of acceptable estimates of expected credit losses for similar assets. However, by not dictating the method to use, the FASB has accepted that different outcomes may result in less comparability. It based its decision on the fact that the credit risks inherent in an entity's financial assets and how the entity manages those risks are unique to the entity. Therefore, the FASB believes each entity should have flexibility to best report its expectations. [ASU 2016-13.BC50]

In explaining its reasoning, the FASB noted that given the subjective nature of the estimate, one method's consideration of time value may have a more direct effect on the estimate of expected credit losses than other methods. Furthermore, some entities may be able to forecast over the contractual term of

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

an asset, while other entities may only be able to forecast over a shorter period. The FASB noted there are several factors that may influence the approach an entity uses to estimate expected credit losses, including:

- the complexity of its portfolio;
- the entity's size;
- access to information; and
- how the entity manages the portfolio.

Due to these and other factors, the FASB concluded that different outcomes for expected credit losses are acceptable. [ASU 2016-13.BC50]

## **Question 4.2.25** Are expected losses associated with risks other than credit risk included in the estimate of expected credit losses?

**Interpretive response:** No, except for the allowance associated with a net investment in a lease. Certain financial assets or off-balance sheet arrangements in the scope of Topic 326 may expose an entity to potential losses from both credit risk and other types of risks (such as fraud, contractual disputes or foreign currency risks). However, only expected losses attributable to credit risk are included in the estimate of expected credit losses under Topic 326. Potential losses related to other risks may have to be recognized under other guidance (including Topic 450). [326-20-55-82]

In some circumstances, a potential loss may have aspects of credit risk and one or more other risks. In these cases, determining whether a risk of loss is primarily related to credit or non-credit requires judgment. For examples of instruments where the risk of loss is outside the scope of Topic 326, see the discussion of foreign currency risk in AFS debt securities (Question 19.3.05) and of dispute risk that affects the collectibility of a reinsurance contract (section 17.3.10).

***Exception for certain non-credit risk in a net investment in a lease***

When determining the loss allowance for a net investment in a lease an entity considers expected gains and losses associated with the unguaranteed residual value even though those expected gains and losses do not relate to credit risk. See section 16.2.

## **Question 4.2.30** Are anticipated costs associated with loss mitigation and/or potential future declines in collateral values included in the estimate of expected credit losses?

**Background:** An entity may anticipate that it will incur a variety of incremental costs relating to its efforts to mitigate credit losses. For example, the entity may anticipate costs associated with:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- collection efforts;
- the foreclosure process (e.g. legal fees);
- owning and operating the asset (e.g. taxes and insurance).

The entity may also anticipate credit losses arising from changes in the fair value of the collateral – either before or after foreclosure.

**Interpretive response:** The following table summarizes whether anticipated costs and changes in collateral values are included in (or excluded from) an entity's estimate of expected credit losses.

| Incurred (or expected to be incurred) before foreclosure | Incurred (or expected to be incurred) after foreclosure |
|---|---|
| **Costs (other than estimated costs to sell)** | |
| **Excluded** from the estimate of expected credit losses.<br>These represent period costs. They are not included in the allowance for credit losses and are not recognized as an expense before they are incurred.<br>If the borrower is required under the loan terms to reimburse the lender for the costs incurred, the lender records a loan receivable for amounts due from the borrower – e.g. through adding the amount to the loan's principal balance. The entity estimates expected credit losses related to that receivable after it has been recognized.<br>If the borrower is not required to reimburse the lender for the cost, the lender recognizes an expense when the cost has been incurred. | **Excluded** from the estimate of expected credit losses.<br>Anticipated costs on the foreclosed assets (i.e. costs expected to be incurred after foreclosure) are excluded from the allowance for expected credit losses. This is because they are associated with the period that the entity has recognized a foreclosed asset, rather than the period that it holds the loan. |
| **Potential future changes in collateral value** | |
| Guidance on collateral-dependent loans is *not* applied:<br>• **Included** in the estimate of expected credit losses.<br>• The entity considers potential changes in collateral values that could occur between the reporting date and the date of foreclosure. [326-20-30-10]<br>Guidance for collateral-dependent loans *is* applied:<br>• **Excluded** from the estimate of expected credit losses.<br>• Potential future changes in collateral values are excluded from the estimate of expected credit losses because the entity uses the fair value of collateral at the reporting date (see section 10.2). | **Excluded** from the estimate of expected credit losses.<br>Changes in value of the foreclosed assets are associated with the period that the entity owns the foreclosed asset, rather than the period that it holds the loan. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 4.2.35** How are expected sales of loans considered when estimating expected credit losses?

**Interpretive response:** It depends. If an entity expects to sell loans with significant credit deterioration, we believe it should incorporate its estimate of future losses from the expected sale when estimating expected credit losses even if the loans to be sold have not yet been specifically identified. This would be the case regardless of whether the planned sale was a one-time, nonrecurring sale or part of a routine pattern of selling loans. For example, if an entity expects to sell loans once they are considered defaulted, it estimates future losses from those sales of defaulted loans when estimating the allowance for credit losses even though it may not yet know which specific loans will default.

Effectively, the expected loss on sale in that scenario is a credit loss that is included in the allowance for credit losses. Therefore, the estimate of expected credit losses reflects the full amount of the expected loss on the sale of the loan – i.e. the difference between the carrying amount and the estimated sales price.

In contrast, when an entity expects to sell loans that do not have significant credit deterioration since origination, we believe any expected losses are not considered to be credit losses and are therefore not included in the allowance for credit losses.

Determining whether a loan has experienced significant credit deterioration requires a judgment for which an entity develops an accounting policy that it applies consistently.

## 4.2.20 Accrued interest receivable

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-5A** An entity may make an accounting policy election, at the class of financing receivable or the major security-type level, not to measure an allowance for credit losses for accrued interest receivables if the entity writes off the uncollectible accrued interest receivable balance in a timely manner. This accounting policy election should be considered separately from the accounting policy election in paragraph 326-20-35-8A. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.

> Writeoffs of Financial Assets

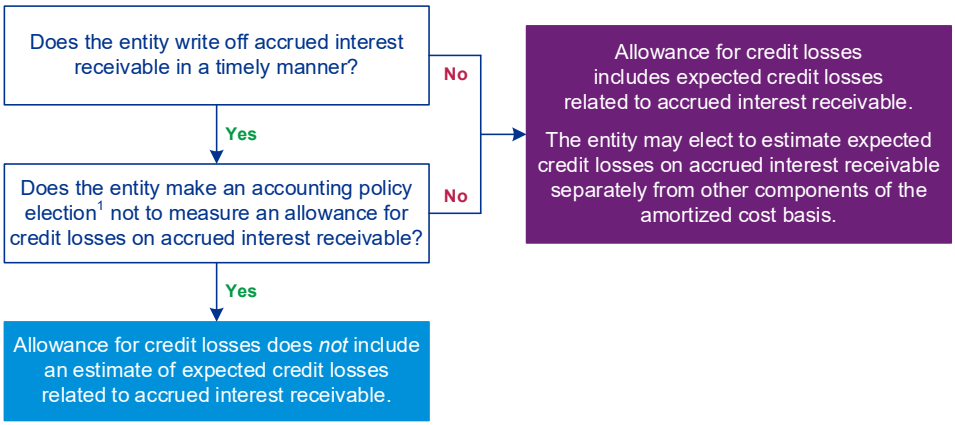
**35-8A** An entity may make an accounting policy election, at the class of financing receivable or the major security-type level, to write off accrued interest receivables by reversing interest income or recognizing credit loss expense or a combination of both. This accounting policy election should be considered separately from the accounting policy election in paragraph 326-20-

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

30-5A. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.

As indicated in section 4.2.10, a financial asset's amortized cost includes the related accrued interest receivable. The FASB provided relief from estimating credit losses on accrued interest receivable balances that an entity writes off in a timely manner. This relief was provided after stakeholders raised concerns, including about the operational burden and cost of tracking accrued interest at the individual loan level, and about some stakeholders' current nonaccrual practice of reversing accrued interest receivable through interest income.

The following decision tree summarizes whether an entity should measure an allowance for credit losses on accrued interest receivable balances. [326-20-30-5 – 30-5A]




Note:

1. The accounting policy election is made at the class of financing receivable or major security-type level.

In addition to permitting an entity to not measure an allowance for credit losses for accrued interest receivable in certain circumstances, the FASB provided relief related to how an entity may write off accrued interest receivable (see Question 4.2.50) and relief from certain presentation and disclosure requirements (see Question 23.2.05 and section 24.2.100, respectively).

## **Question 4.2.40** What time period for writing off accrued interest receivable is considered 'timely'?

**Interpretive response:** The FASB decided not to provide a specific time period that is considered timely. Instead, an entity is required to apply judgment based on its specific facts and circumstances. [ASU 2019-04.BC20]

For example, an entity may have a policy to write off accrued interest receivable when a loan becomes 90 days delinquent. We believe this would generally be considered a timely writeoff policy.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.2.50** Must an entity write off accrued interest receivable as a deduction from the allowance for credit losses?

**Interpretive response:** No. In response to stakeholder concerns about changing the current nonaccrual practice of reversing accrued interest receivable through interest income, the FASB provided relief from the requirement to deduct writeoffs of accrued interest receivable from the allowance for credit losses. Under that relief, an entity may make an accounting policy election to write off accrued interest receivable in any of the following ways; this election is made separately for each class of financing receivable or major security type: [326-20-35-8A]

- reversing interest income;
- recognizing credit loss expense; or
- a combination of both.

An entity's accounting policy election for writing off accrued interest receivable is made separately from its accounting policy election about whether its allowance for credit losses includes expected credit losses of accrued interest receivable.

The following table summarizes how expected credit losses of accrued interest receivable may be reflected in an entity's financial statements; combinations of these outcomes may also result.

| | **Accrued interest receivable is written off through:** | |
|---|---|---|
| | **Reversing interest income** | **Recognizing credit loss expense** |
| **Allowance for credit losses includes expected credit losses of accrued interest receivable** | Credit loss expense, and a related allowance, are initially recognized for expected credit losses of accrued interest receivable.<br>When accrued interest receivable is subsequently deemed uncollectible, interest income is reversed. In addition, related amounts in the allowance for credit losses are reversed, resulting in a decrease to credit loss expense. | Credit loss expense is recognized for expected credit losses of accrued interest receivable.<br>Accrued interest receivable is deducted from the allowance for credit losses when it is deemed uncollectible. |
| **Allowance for credit losses *does not* include expected credit losses of accrued interest receivable** | Interest income is reversed when accrued interest receivable is deemed uncollectible. | Credit loss expense is recognized when accrued interest receivable is deemed uncollectible. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 4.3 Methods other than discounted cash flow methods

## 4.3.10 Overview

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-5** If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including all of the following:

a. Amortized cost basis, excluding applicable accrued interest, premiums, discounts (including net deferred fees and costs), foreign exchange, and fair value hedge accounting adjustments (that is, the face amount or unpaid principal balance).
b. Premiums or discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments. See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge.
c. Applicable accrued interest. See paragraph 326-20-30-5A for guidance on excluding accrued interest from the calculation of the allowance for credit losses.

If a method other than a discounted cash flow method is used, an entity may develop the estimate of expected credit losses by measuring components of the amortized cost basis separately (see Example 4.3.20) or on a combined basis (see Example 4.3.10). [326-20-30-4 – 30-5]

When a loan is acquired at a discount, Subtopic 326-20 precludes an entity from using the discount to offset its expectation of credit losses. Instead, as illustrated in Examples 4.3.10 and 4.3.20, the entity estimates the effect that the discount will have on the expected credit losses of the amortized cost basis. See also Question 12A.2.40.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.3.10** May an entity estimate lifetime expected credit losses by multiplying an average annual loss rate by the financial asset's remaining contractual term?

**Interpretive response:** Generally, no. Because losses do not generally occur evenly over time, an entity's estimate based on an average annual loss rate multiplied by the remaining contractual term may result in either understating or overstating lifetime expected credit losses. Instead, the entity should generally use cumulative lifetime historical loss data as a starting point.

Historical loss experience generally serves as a starting point for estimating expected credit losses under Subtopic 326-20. See chapter 7 for discussion of adjusting the historical experience to reflect management's expectations of current conditions, and reasonable and supportable forecasts.

## **Question 4.3.20** Can an entity discount cash flows when applying a method other than a discounted cash flow method?

**Interpretive response:** It depends. The FASB and TRG observed that although Subtopic 326-20 distinguishes between a discounted cash flow method and other methods, it does not explicitly prohibit the use of discounting when other methods are used. [FASB 11-18, TRG 11-18.14]

We believe the guidance below should be followed when an entity incorporates discounting in its measurement methodology.

| Consideration | Guidance |
|---|---|
| **Cash flows to be discounted** | In general, we believe the entity should discount *all* cash flows. [FASB 11-18, TRG 11-18.14] |
| **EIR for discounting cash flows** | We believe an entity should apply Subtopic 326-20's guidance for calculating the EIR (see section 4.4). |
| **Date to which cash flows are discounted** | The FASB and TRG indicated that an entity is not permitted to discount cash flows or inputs to a date other than the reporting date. [FASB 11-18, TRG 11-18.14]<br>Certain entities are required to discount cash flows to a date other than the reporting date when making estimates for regulatory purposes. For example, under certain provisions of the Basel III capital framework, cash flows that are projected to occur after a loan has defaulted are discounted to the default date, rather than to the reporting date (if earlier). Such an approach cannot be applied when estimating expected credit losses. |

For discussion of whether an entity may estimate expected credit losses by discounting expected losses, see Question 4.4.25.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.3.30** Does an entity reserve for future interest when applying a method other than a discounted cash flow method to estimate expected credit losses?

**Interpretive response:** No. An entity does not reserve for future interest – i.e. interest that has not yet been accrued – when applying a method other than a discounted cash flow method. The FASB and TRG discussed this issue at meetings in August and June 2018, respectively. They agreed that the allowance reflects an entity's expected credit losses of the amortized cost basis at the balance sheet date, and future interest amounts are not part of the amortized cost basis until accrued. [326-20-30-5, TRG 2018-06.8, TRG 2018-06.13]

This approach includes situations in which accrued interest is added to the outstanding principal balance. For example, student loans sometimes have deferment periods during which the borrower does not make payments and accrued interest is added to the outstanding principal balance. In these situations, if an entity uses a method that applies probability of default and loss given default rates to the expected unpaid principal balance at the time of default (i.e. expected exposure at default), the expected unpaid principal balance should not include interest that is expected to be added to the principal balance after the balance sheet date.

Similarly, we do not believe an entity includes contractual interest in its estimate of expected recoveries, unless it was accrued prior to the asset being written off (see Question 3.3.10).

## **Question 4.3.40** What effect do unamortized premiums and discounts have on the estimate of expected credit losses?

**Interpretive response:** In estimating expected credit losses of the amortized cost basis for an asset (or group of assets) using a method other than a discounted cash flow method, the estimate needs to reflect: [326-20-30-5]

- the expected loss of principal;
- the effect of unamortized premiums and discounts, including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments (see section 8.3.30 of KPMG Handbook, Derivatives and hedging, for addition guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge); and
- accrued interest receivable, if applicable (see section 4.2.20).

When an entity uses historical credit loss data to estimate how premiums or discounts will affect future credit losses, we believe it will generally consider what effect (if any) its reasonable and supportable forecasts of future conditions might have on that estimate. For example, expected changes in prepayments as a result of forecasted changes in market interest rates from those observed in the historical period might result in a change in the amount of premium or

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

discount amortization that is recognized before a credit loss. This may affect the amount of unamortized premium or discount reflected in the writeoff amount.

Subtopic 326-20 permits entities to develop the credit loss estimate by considering the components of the amortized cost basis using either:

- a combined approach – i.e. the principal amount together with accrued interest, if applicable, and/or all premiums and discounts; or
- a separate approach.

The FASB decided to permit entities to consider the components of the amortized cost on a separate basis to better help them leverage historical loss information that may frequently be based on unpaid principal balances. [ASU 2016-13.BC59]

We expect that entities will generally choose to analyze the amortized cost basis in a manner (combined or separate) that is consistent with how the historical loss information used in preparing the allowance for credit losses was determined.

If an entity elects to use a combined approach that applies a loss rate based on historical writeoffs of amortized cost, we believe the loss rate could be based on, and then applied to, either the unpaid principal balance or the original amortized cost basis.

## **Example 4.3.10** Applying the combined approach

***Development of historical loss rates and estimation of expected credit losses***

ABC Corp. estimates its allowance for credit losses using a loss-rate method. ABC originates a portfolio of non-prepayable loans that have similar risk characteristics with an original amortized cost basis of $20,400,000 (principal of $20,000,000 and net deferred costs of $400,000).

ABC has a policy to write off accrued interest receivable in a timely manner and has elected not to measure an allowance for expected credit losses on accrued interest receivable. ABC gathered historical loss data for a portfolio of similar assets that it originated in the past and that had a contractual term that was consistent with the contractual term of the portfolio that it just originated. Further, the loans observed in developing the historical loss rate were originated with net deferred costs of similar magnitude in relation to the principal amount as the current portfolio.

The following data are relevant for ABC's historical loan portfolio at the date of its origination.

| | |
|---|---|
| Unpaid principal balance of the loan portfolio [a] | 100,000,000 |
| Loan origination transaction costs pertaining to the loan portfolio [b] | 2,000,000 |
| Amortized cost [c = a + b] | 102,000,000 |

Out of the total portfolio, 10% of the loans defaulted. The following is ABC's historical loss experience on the defaulted loans.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| Unpaid principal balance of the defaulted loans – 10% of $100,000,000 [a] | 10,000,000 |
| Unamortized costs pertaining to the defaulted loans at the time of writeoff [b] | 80,000 |
| Amortized cost at the time of writeoff [c = a + b] | 10,080,000 |
| Cash received as final settlement of the loans [d] | 9,000,000 |
| Writeoff of amortized cost basis [e = c – d] | 1,080,000 |

ABC elects to develop its estimate of expected credit losses by considering the components of the amortized cost on a combined basis, and determines that its historical writeoffs of the amortized cost basis were $1,080,000.

In estimating its expected credit losses, ABC could use an approach that is consistent with how it developed the historical loss rate – i.e. based on either the unpaid principal balance or amortized cost.

***Scenario 1: Historical loss rate based on amortized cost***

ABC determines its historical loss rate based on amortized cost: $1,080,000 ÷ $102,000,000 = 1.059% (rounded).

Next, ABC considers its current asset-specific risk characteristics, the current economic conditions, and reasonable and supportable forecasts of future economic conditions. ABC determines that no adjustment to the historical loss rate is necessary because it expects that credit losses will be consistent with the historical period in terms of both timing and amount.

Because the historical loss rate is based on amortized cost, the rate is applied to the amortized cost basis of the loan portfolio. Therefore, ABC calculates its allowance for credit losses related to this portfolio as $20,400,000 × 1.059% = $216,000.

***Scenario 2: Historical loss rate based on unpaid principal balance***

ABC determines its historical loss rate based on unpaid principal balance: $1,080,000 ÷ $100,000,000 = 1.08%.

Next, ABC considers its current asset-specific risk characteristics, the current economic conditions, and reasonable and supportable forecasts of future economic conditions. ABC determines that no adjustment to the historical loss rate is necessary because it expects that credit losses will be consistent with the historical period in terms of both timing and amount.

Because the historical loss rate is based on unpaid principal balance, the rate is applied to the unpaid principal balance of the loan portfolio. Therefore, ABC calculates its allowance for credit losses related to this portfolio as $20,000,000 × 1.08% = $216,000.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.3.50** Must an entity accumulate new data if it measures the components of the amortized cost separately?

**Interpretive response:** It depends. If an entity develops the expected credit loss estimate by considering the components of amortized cost separately, it needs to consider the effect that the following items have on the expected credit loss estimate:

- accrued interest receivable, if applicable (see section 4.2.20); and
- unamortized premiums and discounts (including net deferred fees and costs, foreign exchange, and fair value hedge accounting adjustments).

For example, the entity needs to consider what amount of unaccreted net deferred fees will remain when a credit loss occurs.

This will represent a new data requirement for entities that have not historically tracked such data.

## **Example 4.3.20** Applying the separate approach

ABC Corp. estimates its allowance for credit losses using a probability of default/loss given default (PD/LGD) method. It has a policy to write off accrued interest receivable in a timely manner and has elected not to measure an allowance for expected credit losses on accrued interest receivable.

ABC originates a portfolio of non-prepayable loans with an original amortized cost basis of $980,000 (principal of $1,000,000 and net deferred fees of $20,000). It estimates that 3% of these loans will default during their lifetimes, and that the loss given default will be 40% of the original principal amount.

ABC analyzes its historical loss experience and determines that credit losses have, on average, occurred when 60% of the original net deferred fees remain unaccreted. Due to current conditions and its reasonable and supportable forecasts of future conditions, ABC adjusts the amount of unaccreted net deferred fees by 10% – from 60% of the original amount to 70% – to account for differences in the expected timing of credit losses compared to the timing observed in the historical period.

ABC elects to develop its estimate of expected credit losses by considering the components of the amortized cost basis on a separate basis.

ABC calculates its allowance for credit losses related to this portfolio as follows.

| | |
|---|---|
| Principal amount | 1,000,000 |
| Principal amount of loans multiplied by PD [$1,000,000 × 3% PD] | 30,000 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| Expected loss on principal amount [$30,000 × 40% LGD] | 12,000 |
| Less: Unaccreted deferred fees included in expected credit loss of amortized cost basis[1] | (420) |
| Allowance for credit losses | 11,580 |

Note:

1. ABC estimates the unaccreted deferred fees at the time credit losses are expected to occur as follows.

| | |
|---|---|
| Total net deferred fees at origination | 20,000 |
| Less: Amount expected to be accreted at the time credit losses are expected to occur [$20,000 × 30%] | (6,000) |
| Unaccreted amount expected at the time credit losses are expected to occur [$20,000 × 70%] | 14,000 |
| Unaccreted amount included in expected credit loss of amortized cost basis [$14,000 × 3% PD] | (420) |

## Excerpt from ASC 326-20

• > Example 1: Estimating Expected Credit Losses Using a Loss-Rate Approach (Collective Evaluation)

**55-18** This Example illustrates one way an entity may estimate expected credit losses on a portfolio of loans with similar risk characteristics using a loss-rate approach.

**55-19** Community Bank A provides 10-year amortizing loans to customers. Community Bank A manages those loans on a collective basis based on similar risk characteristics. The loans within the portfolio were originated over the last 10 years, and the portfolio has an amortized cost basis of $3 million.

**55-20** After comparing historical information for similar financial assets with the current and forecasted direction of the economic environment, Community Bank A believes that its most recent 10-year period is a reasonable period on which to base its expected credit-loss-rate calculation after considering the underwriting standards and contractual terms for loans that existed over the historical period in comparison with the current portfolio. Community Bank A's historical lifetime credit loss rate (that is, a rate based on the sum of all credit losses for a similar pool) for the most recent 10-year period is 1.5 percent. The historical credit loss rate already factors in prepayment history, which it expects to remain unchanged. Community Bank A considered whether any adjustments to historical loss information in accordance with paragraph 326-20-30-8 were needed, before considering adjustments for current conditions and reasonable and supportable forecasts, but determined none were necessary.

**55-21** In accordance with paragraph 326-20-55-4, Community Bank A considered significant factors that could affect the expected collectibility of the amortized cost basis of the portfolio and determined that the primary factors

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

are real estate values and unemployment rates. As part of this analysis, Community Bank A observed that real estate values in the community have decreased and the unemployment rate in the community has increased as of the current reporting period date. Based on current conditions and reasonable and supportable forecasts, Community Bank A expects that there will be an additional decrease in real estate values over the next one to two years, and unemployment rates are expected to increase further over the next one to two years. To adjust the historical loss rate to reflect the effects of those differences in current conditions and forecasted changes, Community Bank A estimates a 10-basis-point increase in credit losses incremental to the 1.5 percent historical lifetime loss rate due to the expected decrease in real estate values and a 5-basis-point increase in credit losses incremental to the historical lifetime loss rate due to expected deterioration in unemployment rates. Management estimates the incremental 15-basis-point increase based on its knowledge of historical loss information during past years in which there were similar trends in real estate values and unemployment rates. Management is unable to support its estimate of expectations for real estate values and unemployment rates beyond the reasonable and supportable forecast period. Under this loss-rate method, the incremental credit losses for the current conditions and reasonable and supportable forecast (the 15 basis points) is added to the 1.5 percent rate that serves as the basis for the expected credit loss rate. No further reversion adjustments are needed because Community Bank A has applied a 1.65 percent loss rate where it has immediately reverted into historical losses reflective of the contractual term in accordance with paragraphs 326-20-30-8 through 30-9. This approach reflects an immediate reversion technique for the loss-rate method.

**55-22** The expected loss rate to apply to the amortized cost basis of the loan portfolio would be 1.65 percent, the sum of the historical loss rate of 1.5 percent and the adjustment for the current conditions and reasonable and supportable forecast of 15 basis points. The allowance for expected credit losses at the reporting date would be $49,500.

# 4.4 Discounted cash flow method

## 4.4.10 Overview

Subtopic 326-20 permits, but does not require, an entity to use a discounted cash flow method to determine the allowance for credit losses. An estimate of expected credit losses that discounts projected future principal and interest cash flows is a discounted cash flow method. If an entity uses a discounted cash flow method, it discounts the expected cash flows at the financial asset's original EIR, as recalculated when certain transactions occur. See sections 4.4.20, 4.4.30 and 4.4.40 for guidance about calculating the EIR. [326-20-30-3 – 30-4]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.4.10** When a discounted cash flow method is used, at what date should cash flows from expected recoveries be included?

**Background:** An entity may have a policy to fully or partially write off a loan when it defaults – e.g. when the loan is 180 days past due. The entity may expect to subsequently recover a portion of the written-off amount.

**Interpretive response:** When a discounted cash flow method is used, we believe that forecasted cash inflows from expected recoveries should be included on the date on which they are expected to be received – as opposed to the date the loan is projected to be written off. For discussion of the timing of recoveries from foreclosed assets, see Question 4.2.30.

In a discounted cash flow method, the estimate of expected credit losses is the present value of expected future principal and interest cash flows discounted using the original EIR (as recalculated when certain transactions occur – see Question 4.4.40). As a result, cash flows are included on the date they are projected to occur. This is the case even if a loan has been (or will be) written off before that date.

For example, if a recovery is expected to occur when the loan is 270 days past due, the cash inflow should be included when the loan is forecast to be 270 days past due. This is the case even if the entity expects to write off the loan before the projected recovery date.

## **Question 4.4.20** When a discounted cash flow method is used, at what date are amounts from expected foreclosed assets included?

**Interpretive response:** When a discounted cash flow method is used and an entity expects to recover amounts through foreclosure, we believe an entity should impute a cash flow for the fair value (less estimated costs to sell) on the expected date of foreclosure – not on the forecasted date of sale of the foreclosed property.

When an entity forecloses on a long-lived asset, the asset is initially recognized at fair value less estimated costs to sell. As discussed in Question 4.2.30, expenses and losses (other than costs to sell) that the entity anticipates incurring subsequent to the foreclosure are associated with the period that the entity owns the asset – rather than the period that it holds the loan – and are not included when estimating the allowance for credit losses before foreclosure. [310-20-40-2 – 20-3]

As a result, a cash inflow should be:

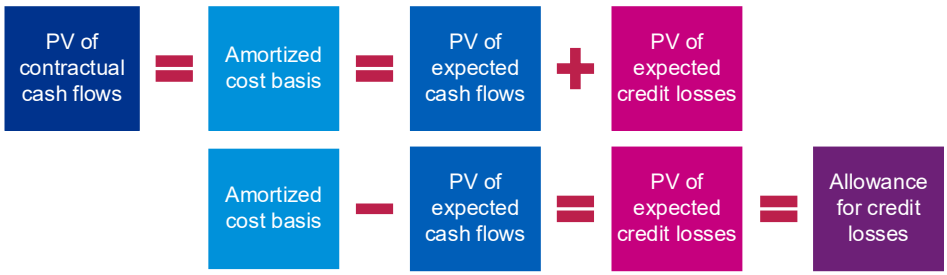
- imputed for the fair value (less estimated costs to sell) of expected foreclosed assets; and
- included in the discounted cash flow approach on the expected date that the loan will be effectively exchanged for the foreclosed property.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.4.25** Can an entity estimate expected credit losses by discounting expected losses?

**Interpretive response:** Yes, provided it results in an allowance for credit losses that is consistent with the allowance that would result by comparing the amortized cost basis to the discounted expected cash flows. This is because the present value of contractual cash flows expected to be collected plus the present value of contractual cash flows *not* expected to be collected (that is, expected credit losses) is equivalent to the present value of all contractual cash flows – i.e. the amortized cost basis. Further, the allowance for credit losses represents the difference between amortized cost basis and the present value of expected cash flows.

These relationships are depicted in the following diagram.




An entity using this approach should be careful to ensure that its methodology results in an allowance for credit losses consistent with the allowance that would have been calculated if the entity had compared the amortized cost basis to the discounted expected cash flows.

For example, to achieve this objective, an entity should:

- discount losses from the date that the cash shortfall is expected, not the date that a charge-off is expected to be recognized; and
- ensure expected recoveries are discounted based on the expected timing of the cash inflows.

An additional complexity of this approach is considering whether the effects of expected prepayments and accruals of interest are consistent with the effects that would have been calculated if the entity had compared the amortized cost basis to the discounted expected cash flows.

## **Example 4.4.05** Discounting expected losses

This example illustrates measuring the allowance for credit losses by discounting expected losses instead of comparing the amortized cost basis to the discounted expected cash flows.

Bank originates a non-prepayable loan to Borrower with the following attributes.

| | |
|---|---|
| Principal amount: | 1,000,000 |
| Discount (deferred fees, net): | 18,714 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| Contractual interest rate: | 10% |
| EIR (based on contractual cash flows): | 10.5% |
| Contractual term: | 5 years |
| Payment terms: | Interest only with balloon at maturity |

Bank calculates the allowance for credit losses by discounting expected credit losses. At origination, Bank estimates the cash flows it expects to collect (and to *not* collect) as follows.

| Year | Contractual cash flows | | Total contractual cash flows | Expected cash flows | Expected credit losses[1] |
|---|---|---|---|---|---|
| | Principal | Interest | | | |
| 1 | 0 | 100,000 | 100,000 | 95,000 | 5,000 |
| 2 | 0 | 100,000 | 100,000 | 97,000 | 3,000 |
| 3 | 0 | 100,000 | 100,000 | 95,000 | 5,000 |
| 4 | 0 | 100,000 | 100,000 | 100,000 | 0 |
| 5 | 1,000,000 | 100,000 | 1,100,000 | 1,020,000 | 80,000 |
| 6 | 0 | 0 | 0 | 0 | 0 |
| 7 | 0 | 0 | 0 | 0 | 0 |
| 8[2] | 0 | 0 | 0 | 50,000 | (50,000) |
| 9[2] | 0 | 0 | 0 | 2,000 | (2,000) |
| Present value at EIR | | | | 945,347 | 35,939 |
| Amortized cost[3] | | | | 981,286 | |
| Allowance for credit losses | | | | 35,939 | 35,939 |

Notes:

1. Total contractual cash flows – Expected cash flows.
2. Expected cash flows in years after contractual maturity result from expected recoveries in those years.
3. Amortized cost at origination is the sum of the principal amount less the discount resulting from deferred fees, net ($1,000,000 – $18,714).

As demonstrated in the table, Bank would calculate the same allowance for expected credit losses by either of the following:

- discounting expected credit losses; or
- comparing the amortized cost basis to the discounted expected cash flows.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 4.4.20 Calculating the EIR

### Excerpt from ASC 310-20

> Estimating Principal Prepayments

**35-26** Except as stated in the following sentence, the calculation of the constant effective yield necessary to apply the interest method shall use the payment terms required by the loan contract, and prepayments of principal shall not be anticipated to shorten the loan term. If the entity holds a large number of similar loans for which prepayments are probable and the timing and amount of prepayments can be reasonably estimated, the entity may consider estimates of future principal prepayments in the calculation of the constant effective yield necessary to apply the interest method. If the entity anticipates prepayments in applying the interest method and a difference arises between the prepayments anticipated and actual prepayments received, the entity shall recalculate the effective yield to reflect actual payments to date and anticipated future payments. The net investment in the loans shall be adjusted to the amount that would have existed had the new effective yield been applied since the acquisition of the loans. The investment in the loans shall be adjusted to the new balance with a corresponding charge or credit to interest income.

### Excerpt from ASC 326-20

**20 Glossary**

**Effective Interest Rate**

The rate of return implicit in the **financial asset**, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset. For **purchased financial assets with credit deterioration**, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition.

> Developing an Estimate of Expected Credit Losses

**30-4** If an entity estimates expected credit losses using methods that project future principal and interest cash flows (that is, a discounted cash flow method), the entity shall discount expected cash flows at the financial asset's **effective interest rate**. When a discounted cash flow method is applied, the allowance for credit losses shall reflect the difference between the amortized cost basis and the present value of the expected cash flows. If a financial asset is modified and is considered to be a continuation of the original asset, an entity shall use the post-modification contractual interest rate to derive the effective interest rate when using a discounted cash flow method. See paragraph 815-25-35-10 for guidance on the treatment of a basis adjustment related to an existing portfolio layer method hedge. If the financial asset's contractual interest rate varies based on subsequent changes in an

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that financial asset's effective interest rate (used to discount expected cash flows as described in this paragraph) shall be calculated based on the factor as it changes over the life of the financial asset. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-20-30-4A. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

**30-4A** As an accounting policy election for each class of financing receivable or major security type, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments.

• > Effect of a Fair Value Hedge on the Discount Rate When Using a Discounted Cash Flow Method

**55-9** Section 815-25-35 implicitly affects the measurement of credit losses under this Topic by requiring the present value of expected future cash flows to be discounted by the new **effective interest rate** based on the adjusted **amortized cost basis** in a hedged **loan**. When the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the effective interest rate is the discount rate that equates the present value of the loan's future cash flows with that adjusted amortized cost basis. The adjustment under fair value hedge accounting of the loan's carrying amount for changes in fair value attributable to the hedged risk under Section 815-25-35 shall be considered to be an adjustment of the loan's amortized cost basis. Paragraph 815-25-35-11 explains that the loan's original effective interest rate becomes irrelevant once the recorded amount of the loan is adjusted for any changes in its fair value. Paragraph 815-25-35-11 also explains that an entity should not adjust the amortized cost basis or the discount rate of the individual assets or individual beneficial interest included in the closed portfolio for a basis adjustment that is maintained on the closed portfolio basis in accordance with paragraph 815-25-35-1(c).

## Excerpt from ASC 835-30

**20 Glossary**

**Interest Method**

The method used to arrive at a periodic interest cost (including amortization) that will represent a level effective rate on the sum of the face amount of the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

debt and (plus or minus) the unamortized premium or discount and expense at the beginning of each period.

An EIR is used to either:

- discount projected future principal and interest cash flows when estimating expected credit losses using a discounted cash flow method under Topic 326; or
- recognize interest income on financial assets under Topic 310.

ASU 2016-13, which introduced Topic 326, did not make substantive changes to the guidance in Subtopic 310-20 regarding the recognition of interest income or the accretion/amortization of nonrefundable fees and other costs. As a result, the EIR under Topic 326 may not be the same as the rate used to recognize interest income under Topic 310.

The following table compares how the EIR for recognizing interest income compares to the EIR used to discount expected cash flows for determining the allowance.

| Instrument | EIR used to recognize interest income | EIR used to discount expected cash flows for determining the allowance for credit losses |
|---|---|---|
| **Prepayable fixed rate financial assets** | **General requirement**<br>EIR is based on contractual terms. [310-20-35-26]<br>**Exception**<br>For large numbers of similar loans for which prepayments are probable and the timing and amounts can be reasonably estimated, EIR is based on: [310-20-35-26]<br>• contractual cash flows; or<br>• prepayment-adjusted EIR. If there is a difference between anticipated and actual prepayments, a new EIR is calculated. The net investment in the asset is adjusted to the amount that would have existed had the new EIR been applied since acquisition of the asset. | Policy election (for each class of financing receivable or major security type) to calculate the EIR based on: [326-20-30-4A, 326-30-35-11, 35-7A]<br>• contractual cash flows; or<br>• prepayment-adjusted EIR, considering the timing (and changes in timing) of expected cash flows resulting from expected prepayments. If there is a difference between anticipated and actual prepayments, the adjustment to EIR is prospective. |
| **Non-prepayable fixed rate financial assets** | EIR is based on contractual terms. [310-20-35-26] | EIR is based on contractual terms. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Instrument | EIR used to recognize interest income | EIR used to discount expected cash flows for determining the allowance for credit losses |
|---|---|---|
| **Variable rate financial assets** | EIR is calculated based on: [310-20-35-18(c), 35-20]<br>• the factor as it changes over the life of the asset; or<br>• fixed at the rate in effect at inception of the asset. | **Loans and HTM debt securities**<br>EIR is calculated based on the independent factor as it changes over the life of the financial asset. [326-20-30-4]<br>**AFS debt securities**<br>EIR is calculated based on: [326-30-35-11]<br>• the factor as it changes over the life of the AFS debt security; or<br>• fixed at the rate in effect at the time of the most recent credit loss.<br>A consistent method should be applied for all securities that have a contractual interest rate that varies based on changes in an independent factor. [326-30-35-11]<br>**All financial assets**<br>Projections of changes in the factor are not required when estimating expected future cash flows for determining the allowance for credit losses. However, if such projections are made, the same projections are used in calculating the EIR used for discounting those expected future cash flows. Further, in this situation, the EIR is also adjusted for expected prepayments. [326-20-30-4, 326-30-35-11] |

The focus of the discussion in the remainder of this section is the EIR used in a discounted cash flow method when determining the allowance for credit losses under Subtopic 326-20.

The EIR is the rate of return implicit in the financial asset. It is the financial asset's stated contractual rate adjusted for any purchase or origination date net deferred fees or costs, premiums or discounts. [326-20 Glossary]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 4.4.30** How is the EIR calculated under Subtopic 326-20?

**Interpretive response:** The EIR is the rate of return implicit in a financial asset. Generally it is the interest rate that equates the present value of an asset's cash flows with the asset's amortized cost basis on the acquisition or origination date.

Calculating this rate requires adjusting the asset's contractual interest rate for net deferred fees or costs, and premiums or discounts existing at the origination or acquisition of the financial asset. When a loan is modified, the EIR is calculated based on the receivable's modified (not original) contractual terms (see Question 4.4.40). [326-20 Glossary]

Additional guidance applies when the EIR is adjusted for prepayment assumptions (see section 4.4.30) and for variable rate assets (see section 4.4.40).

When a loan is written off, the EIR for estimating recoveries is unchanged from the rate immediately before writeoff.

## **Question 4.4.40** Is the EIR recalculated when a financial asset's amortized cost basis changes?

**Interpretive response:** Yes. Subtopic 310-20 addresses transactions for which the rate used for recognizing interest income should be adjusted throughout the life of a financial asset due to changes in its amortized cost basis.

We believe when those transactions occur, an entity should also adjust the EIR used to determine the allowance for credit losses.

Those transactions include the following: [310-20-35-10, 35-34]

- transactions in which additional fees are collected;
- costs are incurred or prepayment penalties are charged in conjunction with a loan modification; and
- fees are received by the lender unrelated to the origination of the loan.

Further, when the amortized cost basis of a loan has been adjusted under fair value hedge accounting, the EIR is adjusted to equate the present value of the loan's future cash flows with the adjusted amortized cost basis. [326-20-55-9]

## **Example 4.4.10** Discounted cash flow method – changes in EIR due to additional costs

This example illustrates the effect of the EIR on the determination of the allowance for credit losses when additional costs are incurred. To isolate this effect, the example assumes that no credit losses are expected. Actual scenarios would generally include a credit loss assumption.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Bank makes a loan to Borrower with the following attributes.

| | |
|---|---|
| Unpaid principal balance (UPB): | 1,000,000 |
| Premium: | 24,500 |
| Contractual payment amount: | 129,505 |
| Contractual interest rate: | 5.00% |
| EIR (based on contractual cash flows): | 4.50% |
| Contractual term: | 10 years |
| Payment terms: | Annual payments |

The loan is prepayable without penalty; however, Bank does not expect that Borrower will prepay the loan.

The loan has the following contractual amortization schedule.

| Year | Beginning principal balance | Scheduled payment | | Ending principal balance | Ending premium balance | Ending amortized cost |
|---|---|---|---|---|---|---|
| | | Principal | Interest | | | |
| | | | | 1,000,000 | 24,500 | 1,024,500 |
| 1 | 1,000,000 | 79,505 | 50,000 | 920,495 | 20,650 | 941,145 |
| 2 | 920,495 | 83,480 | 46,025 | 837,015 | 17,020 | 854,035 |
| 3 | 837,015 | 87,654 | 41,851 | 749,361 | 13,641 | 763,002 |
| 4 | 749,361 | 92,037 | 37,468 | 657,324 | 10,543 | 667,867 |
| 5 | 657,324 | 96,639 | 32,866 | 560,685 | 7,762 | 568,447 |
| 6 | 560,685 | 101,470 | 28,035 | 459,215 | 5,334 | 464,549 |
| 7 | 459,215 | 106,544 | 22,961 | 352,671 | 3,299 | 355,970 |
| 8 | 352,671 | 111,871 | 17,634 | 240,800 | 1,701 | 242,501 |
| 9 | 240,800 | 117,465 | 12,040 | 123,335 | 585 | 123,920 |
| 10 | 123,335 | 123,335 | 6,170 | 0 | 0 | 0 |

Bank has determined that the loan to Borrower does not share similar risk characteristics with other loans; therefore, it has decided to estimate expected credit losses on this loan separately.

Bank uses discounted cash flows to estimate expected credit losses. At the end of Year 5, Bank modifies the loan to remove certain collateral requirements and incurs additional costs of $20,000 related to the modification. The modification does not result in more than minor modifications to the loan; therefore, it is accounted for as a continuation of the original loan. After including the additional costs as an increase to the premium on the loan, the amortized cost basis of the loan is $588,447 at the end of Year 5.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Ending principal balance | Ending original premium balance | Additional costs | Ending amortized cost |
|---|---|---|---|---|
| 5 | 560,685 | 7,762 | 20,000 | 588,447 |
| 6 | 459,215 | 5,334 | 13,671 | 478,220 |
| 7 | 352,671 | 3,299 | 8,411 | 364,381 |
| 8 | 240,800 | 1,701 | 4,313 | 246,814 |
| 9 | 123,335 | 585 | 1,474 | 125,394 |
| 10 | 0 | 0 | 0 | 0 |

At the end of Year 5, Bank calculates an updated EIR of 3.28% – i.e. the rate that equates the present value of the expected cash flows to the new amortized cost basis (exclusive of accrued interest) of $588,447.

Bank's expected cash flows are shown in the table.

| Year | Expected cash flow |
|---|---|
| 6 | 129,505 |
| 7 | 129,505 |
| 8 | 129,505 |
| 9 | 129,505 |
| 10 | 129,505 |

If Bank incorrectly did not adjust the EIR as required and instead discounted the expected cash flows at the original EIR based on the contractual cash flows (over the contractual term) of 4.50%, the present value of the expected cash flows would have been $568,447 at the end of Year 5.

The use of the incorrect EIR would have an effect on the estimate of expected credit losses, despite the assumption of no expected credit losses. When the present value is compared to the amortized cost basis of $588,447, the resulting estimated expected credit loss at the end of Year 5 would be $20,000 – i.e. the amount of the additional costs incurred.

However, because Bank correctly used the updated EIR of 3.28% to discount the expected cash flows, the present value of the expected cash flows is $588,447. When compared to the amortized cost basis of $588,447, the resulting estimated expected credit loss at Year 5 is $0, which is consistent with the simplifying assumption of no expected credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 4.4.30 Calculating the EIR – Prepayment considerations

### Question 4.4.50 How is the prepayment-adjusted EIR determined?

**Interpretive response:** The prepayment-adjusted EIR is the rate that equates the present value of the expected cash flows including prepayment expectations to the amortized cost basis, exclusive of accrued interest. Those expected cash flows should be based on contractual cash flows and only adjusted for prepayment expectations.

If differences arise between the expected prepayments and actual prepayments received, an entity recalculates the EIR to reflect actual payments to date and anticipated future payments. Similarly, if an entity changes its future expectations regarding prepayments, the EIR should be updated for those changes in expectations. [TRG 06-17.1, TRG 06-17.6]

As discussed in Question 6.2.50, an entity is permitted (but not required) to consider the guidance in paragraphs 310-20-35-9 to 35-12 when determining whether a refinancing constitutes a prepayment when estimating expected credit losses. We believe this includes estimating prepayments when using a prepayment-adjusted EIR. [TRG 2018-06.12, TRG 2018-06.13]

### Question 4.4.60 Why would an entity elect to use a prepayment-adjusted EIR to discount cash flows?

**Interpretive response:** An accounting issue arises when an entity:

- considers prepayment expectations in estimating future principal and interest cash flows when applying a discounted cash flow method (regardless of the types of loans involved), which is required by Subtopic 326-20; but [326-20-30-6]
- discounts the prepayment-adjusted expected cash flows at an EIR that is not adjusted for prepayments – i.e. an EIR based on contractual cash flows (see Question 4.3.30). [310-20-35-26]

This approach would result in differences between the amortized cost of the financial asset and the present value of the expected cash flows. These differences would always increase the allowance for credit losses for financial assets held at a premium and offset the allowance for those held at a discount; see Example 4.4.20 for an illustration of the effect. These differences do not represent expected credit losses, but rather would be solely because of the inconsistency of including prepayment expectations in the projected cash flows but excluding prepayment expectations when determining the EIR. This inconsistency is not expected to arise when methods other than discounted cash flows are used to estimate the allowance for credit losses.

To resolve this issue, an entity is permitted to make an accounting policy election (for each class of financing receivable or major security type) to incorporate prepayment assumptions to determine an EIR used to discount

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

expected cash flows when estimating credit losses under Subtopic 326-20. [326-20-30-4A]

If an entity does not make this election, it determines the EIR using the contractual cash flows without considering prepayment assumptions. [TRG 06-17.1, TRG 06-17.6]

## **Example 4.4.20** Effect of using a prepayment-adjusted EIR

This example illustrates the effect of the EIR on the determination of the allowance for credit losses. To isolate this effect of prepayments, the example assumes that no credit losses are expected. Actual scenarios would generally include a credit loss assumption.

Bank makes a loan to Borrower with the following attributes.

| | |
|---|---|
| Unpaid principal balance (UPB): | 1,000,000 |
| Premium: | 24,500 |
| Contractual payment amount: | 129,505 |
| Contractual interest rate: | 5.00% |
| EIR based on contractual cash flows: | 4.50% |
| Contractual term: | 10 years |
| Payment terms: | Annual payments |

The loan is prepayable without penalty. The loan has the following contractual amortization schedule.

| Year | Beginning principal balance | Scheduled payment | | Ending principal balance | Ending premium balance | Ending amortized cost |
|---|---|---|---|---|---|---|
| | | Principal | Interest | | | |
| | | | | 1,000,000 | 24,500 | 1,024,500 |
| 1 | 1,000,000 | 79,505 | 50,000 | 920,495 | 20,650 | 941,145 |
| 2 | 920,495 | 83,480 | 46,025 | 837,015 | 17,020 | 854,035 |
| 3 | 837,015 | 87,654 | 41,851 | 749,361 | 13,641 | 763,002 |
| 4 | 749,361 | 92,037 | 37,468 | 657,324 | 10,543 | 667,867 |
| 5 | 657,324 | 96,639 | 32,866 | 560,685 | 7,762 | 568,447 |
| 6 | 560,685 | 101,470 | 28,035 | 459,215 | 5,334 | 464,549 |
| 7 | 459,215 | 106,544 | 22,961 | 352,671 | 3,299 | 355,970 |
| 8 | 352,671 | 111,871 | 17,634 | 240,800 | 1,701 | 242,501 |
| 9 | 240,800 | 117,465 | 12,040 | 123,335 | 585 | 123,920 |
| 10 | 123,335 | 123,335 | 6,170 | 0 | 0 | 0 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Bank has determined that the loan to Borrower does not share similar risk characteristics with other loans; therefore, it estimates expected credit losses on this loan separately. [326-20-30-2]

Bank uses discounted cash flows to estimate expected credit losses. For simplicity, assume that Bank expects to collect the amortized cost basis of the loan with full prepayment at the end of Year 5.

Bank's expected cash flows are as follows.

| Year | Expected cash flow |
|---|---|
| 1 | 129,505 |
| 2 | 129,505 |
| 3 | 129,505 |
| 4 | 129,505 |
| 5[1] | 690,190 |

Note:

1. $657,324 (unpaid principal balance at the beginning of Year 5) + $32,866 (interest accrued during Year 5).

***Scenario 1: Discount at EIR based on contractual cash flows over the contractual term (i.e. EIR is not adjusted for expected prepayments)***

Using discounted cash flows to estimate credit losses, Bank discounts the expected cash flows (which consider full prepayment in Year 5) at 4.50%, the EIR based on contractual cash flows with the following results.

| Year | Amortized cost basis | Present value of cash flows | Allowance for credit losses |
|---|---|---|---|
| Origination | 1,024,500 | 1,018,275 | 6,225 |
| 1 | 941,145 | 934,639 | 6,506 |
| 2 | 854,035 | 847,236 | 6,799 |
| 3 | 763,002 | 755,896 | 7,106 |
| 4 | 667,867 | 660,442 | 7,425 |
| 5 | 0 | 0 | 0 |

Despite the fact that this example uses a simplifying assumption of zero credit losses (solely to isolate the effect of the EIR), an allowance for credit losses still arises solely due to the inconsistency in the consideration of prepayment expectations between estimated future cash flows (which incorporate prepayment expectations) and the EIR based on contractual cash flows (which does not incorporate prepayment expectations). The remaining allowance of $7,425 would be reversed when the loan prepays in Year 5.

***Scenario 2: Discount at the prepayment-adjusted EIR***

Using its expectation of cash flows, Bank calculates a prepayment-adjusted EIR of 4.34% (rounded) – i.e. the rate that equates the present value of the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

expected cash flows including prepayment expectations to the initial amortized cost basis (exclusive of accrued interest) of $1,024,500.

The following is the amortization table based on the prepayment-adjusted cash flows.

| Year | Beginning principal balance | Expected payment | | Ending principal balance | Ending premium balance | Ending amortized cost |
|---|---|---|---|---|---|---|
| | | Principal | Interest | | | |
| | | | | 1,000,000 | 24,500 | 1,024,500 |
| 1 | 1,000,000 | 79,505 | 50,000 | 920,495 | 18,950 | 939,445 |
| 2 | 920,495 | 83,480 | 46,025 | 837,015 | 13,685 | 850,700 |
| 3 | 837,015 | 87,654 | 41,851 | 749,361 | 8,743 | 758,104 |
| 4 | 749,361 | 92,037 | 37,468 | 657,324 | 4,167 | 661,491 |
| 5 | 657,324 | 657,324 | 32,866 | 0 | 0 | 0 |

Using discounted cash flows to estimate credit losses, Bank discounts the expected cash flows (which consider full prepayment in Year 5 at 4.34%) using the EIR based on the contractual cash flows (over the contractual term) adjusted for prepayment expectations with the following results.

| Year | Amortized cost basis | Present value of cash flows | Allowance for credit losses |
|---|---|---|---|
| Origination | 1,024,500 | 1,024,500 | 0 |
| 1 | 939,445 | 939,445 | 0 |
| 2 | 850,700 | 850,700 | 0 |
| 3 | 758,104 | 758,104 | 0 |
| 4 | 661,491 | 661,491 | 0 |
| 5 | 0 | 0 | 0 |

The result is consistent with the assumption that no credit losses were expected at any point during this loan's life.

## 4.4.40 Calculating the EIR – Variable rate loan considerations

### **Question 4.4.80** How is the EIR calculated under Subtopic 326-20 for a variable rate loan?

**Interpretive response:** Subtopic 326-20 provides the two alternatives outlined below.

***EIR is based on independent factor as it changes over life of loan***

Subtopic 326-20 indicates that if the financial asset's stated interest rate is based on an index or rate that varies based on subsequent changes in an

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

independent factor (e.g. the prime rate), the EIR may be calculated based on the factor as it changes over the life of the loan. [326-20-30-4, 310-20-35-18(c)]

This means that an entity uses the current market rate at the reporting date and does not project changes in the independent factor when determining the EIR. Therefore, an entity assumes that the factor does not change over the remaining life of the asset. [326-20-30-4, 310-20-35-18(c)]

Financial assets with initial fixed interest rates that become adjustable in the future based on subsequent changes in an independent factor are included in this guidance. Therefore, an entity should forecast contractual cash flows using the:

- initial fixed interest rate over the fixed period; and
- current rate for the independent factor, without projecting changes in the independent factor, over the variable period.

***EIR is based on projections of independent factor***

Alternatively, an entity may adjust the EIR based on projections of the independent factor. When an entity elects this alternative, it is also required to: [326-20-30-4]

- use the same projections for purposes of estimating expected future cash flows that it used when determining the EIR; and
- adjust the EIR to consider the effect of expected prepayments.

## **Example 4.4.30** EIR used to calculate the allowance for credit losses – variable rate loan

Bank makes a loan to Borrower with the following attributes.

| | |
|---|---|
| Unpaid principal balance (UPB) (initial): | 100,000 |
| Stated interest rate: | Prime on Jan. 1 + 100 bps |
| Contractual term: | 10 years |
| Payment terms: | Annual payments |

The loan is prepayable without penalty. Prime is 7.25% in Year 1, 8.25% in Year 2, 7.25% in Year 3 and 3.25% in Year 4.

For purposes of estimating expected credit losses, Bank makes the following elections related to determining the EIR used to discount expected cash flows when estimating credit losses.

- Bank does not elect to project changes in the prime rate for purposes of estimating cash flows or determining the EIR. Instead, Bank keeps the rate unchanged in future periods.
- Bank elects to incorporate prepayment assumptions.

The contractual amortization schedule follows. Years 1-4 are actual rates and Years 5-10 represent the prime rate in effect at the end of Year 4 without projecting further change in the prime rate.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Beginning principal balance | Contractual payment[1] | Scheduled payment | | Ending principal balance |
|---|---|---|---|---|---|
| | | | Principal | Interest | |
| 1 | 100,000 | 15,071 | 6,821 | 8,250 | 93,179 |
| 2 | 93,179 | 15,700 | 7,081 | 8,619 | 86,098 |
| 3 | 86,098 | 15,125 | 8,022 | 7,103 | 78,076 |
| 4 | 78,076 | 13,129 | 9,811 | 3,318 | 68,265 |
| 5 | 68,265 | 13,129 | 10,228 | 2,901 | 58,037 |
| 6 | 58,037 | 13,129 | 10,662 | 2,467 | 47,375 |
| 7 | 47,375 | 13,129 | 11,116 | 2,013 | 36,259 |
| 8 | 36,259 | 13,129 | 11,588 | 1,541 | 24,671 |
| 9 | 24,671 | 13,129 | 12,080 | 1,049 | 12,591 |
| 10 | 12,591 | 13,129 | 12,591 | 538 | 0 |

Note:
1. The contractual payment amount varies each period as the variable spot interest rate changes.

At the end of Year 4, Bank expects full prepayment at the end of Year 7. Bank calculates the prepayment-adjusted EIR as the rate that equates the present value of the contractual cash flows, adjusted for prepayment expectations, to the amortized cost basis (exclusive of accrued interest).

| | |
|---|---|
| Amortized cost basis Year 4: | 68,265 |
| Expected payment Year 5: | 13,129 |
| Expected payment Year 6: | 13,129 |
| Expected payment Year 7[1]: | 49,388 |

Note:
1. $47,375 (amortized cost at the beginning of Year 7) + $2,013 (interest accrued during Year 7).

At the end of Year 4, the rate that equates the present value of the expected cash flows, including prepayment assumptions, to the amortized cost basis (exclusive of accrued interest) is 4.25% (prime rate of 3.25% at the end of Year 4 +100 bps).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 5. Collective assessment

## Detailed contents

**5.1 How the standard works**

**5.2 Identifying pools**

5.2.10 Overview

**Questions**

**Question 5.2.10** Must an entity pool assets based on similar risk characteristics?

**Question 5.2.20** Must an entity revise pools of financial assets if risk characteristics change?

**Question 5.2.30** [Not used]

**Question 5.2.40** Is the collective assessment guidance applied to off-balance sheet credit exposures?

**5.3 Changes to pools**

5.3.10 Overview

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 5.1 How the standard works

An entity estimates expected credit losses of financial assets with similar risk characteristics on a collective (pool) basis.

A financial asset is measured individually only if it does not share similar risk characteristics with other financial assets.

Both credit and non-credit related characteristics are relevant in determining whether certain assets share similar risk characteristics.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 5.2 Identifying pools

## 5.2.10 Overview

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-2** 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). If an entity determines that a financial asset does not share risk characteristics with its other financial assets, the entity shall evaluate the financial asset for expected credit losses on an individual basis. If a financial asset is evaluated on an individual basis, an entity also should not include it in a collective evaluation. That is, financial assets should not be included in both collective assessments and individual assessments.

> Developing an Estimate of Expected Credit Losses

**55-5** In evaluating **financial assets** on a collective (pool) basis, an entity should aggregate financial assets on the basis of similar risk characteristics, which may include any one or a combination of the following (the following list is not intended to be all inclusive):

a. Internal or external (third-party) credit score or credit ratings
b. Risk ratings or classification
c. Financial asset type
d. Collateral type
e. Size
f. **Effective interest rate**
g. Term
h. Geographical location
i. Industry of the borrower
j. Vintage
k. Historical or expected credit loss patterns
l. Reasonable and supportable forecast periods.

• > Disclosure—Application of the Term Credit Quality Indicator

**55-15** This implementation guidance addresses application of the term **credit quality indicator**. Examples of credit quality indicators include all of the following:

a. Consumer credit risk scores
b. Credit-rating-agency ratings
c. An entity's internal credit risk grades
d. Debt-to-value ratios
e. Collateral
f. Collection experience
g. Other internal metrics.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**20 Glossary**

**Credit quality indicator**

A statistic about the credit quality of a **financial asset**.

Expected credit losses for financial assets are estimated on a collective – i.e. pool – basis. Financial assets with similar risk characteristics are pooled. Subtopic 326-20 contains several risk characteristics that may be relevant in identifying pools of financial assets. [326-20-30-2, 55-5]

## **Question 5.2.10** Must an entity pool assets based on similar risk characteristics?

**Interpretive response:** Yes. An entity estimates expected credit losses of financial assets with similar risk characteristics collectively. [326-20-30-2]

Subtopic 326-20 provides a list of characteristics that an entity may consider in aggregating financial assets into pools. This list includes both credit and non-credit related characteristics. Although Subtopic 326-20 does not specifically require an entity to consider a financial asset's primary credit quality indicator(s) when aggregating financial assets, we would generally expect an entity to factor in some credit related characteristics. [326-20-55-5, 55-15]

The FASB proposed requiring the estimate of expected credit losses to consider multiple outcomes. However, based on feedback received during deliberations, the FASB decided to require an entity to estimate losses on a collective basis instead of requiring the estimate to consider multiple outcomes. This is because constituents were concerned "that the multiple-outcome approach could be interpreted as requiring complex modeling techniques." This decision was anchored in the FASB's understanding that although there is no requirement to do so under legacy US GAAP, collective approaches are often used in practice. [ASU 2016-13.BC68, BC66]

In requiring a pool-based estimate, the FASB reasoned that while an entity may expect to collect all the contractual cash flows 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." [ASU 2016-13.BC69]

From an operational perspective, we believe there may be circumstances in which an entity would be permitted to estimate expected credit losses on an individual basis, despite sharing similar risk characteristics with other financial assets. An entity would need to support (either qualitatively or quantitatively) that the estimation method applied would generally be expected to achieve results similar to a collective estimate. [ASU 2016-13.BC70]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 5.2.20** Must an entity revise pools of financial assets if risk characteristics change?

**Interpretive response:** Yes. An entity evaluates whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the pool. A financial asset is moved to another pool or evaluated individually if it does not continue to share similar risk characteristics with other financial assets in the pool. [326-20-35-2]

Having factored in some credit characteristics when pooling financial assets (see Question 5.2.10), we would expect an entity to revise the composition of the financial assets in a pool if there are changes in credit risk or other risks such that the assets are no longer considered to share similar risk characteristics.

If an asset no longer shares similar risk characteristics with other financial assets in the pool and does not share similar risk characteristics with another pool, it is evaluated on an individual basis and should not be included in the collective evaluation. [326-20-30-2]

For example, if an asset is removed from a pool for which a loss-rate method is used to estimate expected credit losses, the entity should evaluate the loss rate for the pool to ensure that the losses are not being double counted – i.e. factored into the losses at both the pool level and individual level.

### **Question 5.2.40** Is the collective assessment guidance applied to off-balance sheet credit exposures?

**Interpretive response:** Yes. We believe the collective assessment guidance should be applied by analogy to off-balance sheet credit exposures even though they do not represent financial assets. This is because the guidance for off-balance sheet credit exposures refers to estimating expected losses based on the guidance in Subtopic 326-20. [326-20-30-2, 30-11]

## 5.3 Changes to pools

### 5.3.10 Overview

#### Excerpt from ASC 326-20

> Reporting Changes in Expected Credit Losses

**35-2** An entity shall evaluate whether a financial asset in a pool continues to exhibit similar risk characteristics with other financial assets in the pool. For example, there may be changes in credit risk, borrower circumstances, recognition of writeoffs, or cash collections that have been fully applied to principal on the basis of nonaccrual practices that may require a reevaluation to determine if the asset has migrated to have similar risk characteristics with

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

assets in another pool, or if the credit loss measurement of the asset should be performed individually because the asset no longer has similar risk characteristics.

Pools used to collectively estimate expected credit losses are not static. If an asset in a pool no longer exhibits the same risk characteristics as the other assets in a pool, it should be removed from the pool. It can either be measured for expected credit losses individually or placed in another pool, if appropriate. Subtopic 326-20 gives several examples of changes that may lead to removing an asset from a pool. [326-20-35-2]

## Excerpt from ASC 326-20

• > Example 4: Estimating Expected Credit Losses Using both a Collective Method and an Individual Asset Method

**55-32** This Example illustrates a situation in which loans with credit deterioration are evaluated individually because they no longer exhibit risk characteristics similar to other loans. There is no requirement to evaluate financial assets individually when a certain level of credit deterioration has occurred. However, the assessment of whether financial assets exhibit similar risk characteristics should be based on the relevant and appropriate facts and circumstances.

**55-33** An entity may estimate expected credit losses for some financial assets on a collective (pool) basis and may estimate expected credit losses for other assets on an individual basis when similar risk characteristics do not exist. As a result, the method used to estimate expected credit losses for a financial asset may change over time. For example, a pool of homogeneous loans may initially use a loss-rate method, but certain individual loans no longer may have similar risk characteristics because of credit deterioration. When a financial asset no longer shares similar risk characteristics with the original pool of financial assets, an entity should evaluate that financial asset to determine whether it shares risk characteristics similar to other pools of loans. Expected credit losses of that financial asset should be measured individually if there are no similar risk characteristics with other loans. A discounted cash flow approach is one method to estimate expected credit losses of individual loans, but it is not a required method. Paragraphs 326-20-55-34 through 55-36 illustrate those concepts.

**55-34** One loan program from Bank D provides unsecured commercial loans of up to $75,000 to small businesses and entrepreneurs. Given the relative homogeneity of the borrowers (in terms of credit risk) and loans (in terms of type, amount, and underwriting standards) in the program, Bank D manages this loan program on a collective basis. However, Bank D concludes that the loss estimates for loans with credit deterioration is based on borrower-specific facts and circumstances because the repayment of those loans depends on facts and circumstances unique to each borrower. Therefore, Bank D estimates expected credit losses on an individual basis for loans that no longer exhibit similar risk characteristics because of credit deterioration. A loss-rate method for estimating expected credit losses on a pooled basis is applied for

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

the loans in the portfolio segment that continue to exhibit similar risk characteristics.

**55-35** To estimate expected credit losses for individual loans without similar risk characteristics, Bank D uses a discounted cash flow method for each loan. Frequently, Bank D has insight into the likelihood of a credit loss as a result of information provided by the borrower and recent discussions with the borrower given the elevated credit risk for these loans. Under a discounted cash flow method, the allowance for credit losses is estimated as the difference between the amortized cost basis and the present value of cash flows expected to be collected.

**55-36** To estimate expected credit losses for the remainder of the loans that continue to exhibit similar risk characteristics, Bank D considers historical loss information (updated for current conditions and reasonable and supportable forecasts that affect the expected collectibility of the amortized cost basis of the pool) using a loss-rate approach.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 6. Contractual term

## Detailed contents

**6.1 How the standard works**

**6.2 Determining the contractual term**

6.2.10 Intention to renew

6.2.20 Options to extend the contractual term

6.2.30 Call options

6.2.40 Expected prepayments

**Questions**

**Question 6.2.10** What is the effect on the contractual term of a borrower's option to extend the maturity date of a funded loan?

**Question 6.2.20** What is the effect on the contractual term of a lender's option to extend the maturity date of a funded loan?

**Question 6.2.25** Is it appropriate for an entity to assume that all (or no) extension or renewal options will be exercised?

**Question 6.2.30** What is the effect on the contractual term of a call option held by the lender?

**Question 6.2.40** May the weighted-average remaining life be used as the contractual term for a portfolio of loans?

**Question 6.2.50** Must a lender use the loan modification guidance to determine whether a refinancing should be considered a prepayment?

**Question 6.2.60** Are reasonable and supportable forecasts of future economic conditions considered in developing a prepayment assumption?

**Question 6.2.70** Can an entity assume that prepayments will occur at a constant rate over the remaining contractual term?

**Examples**

**Example 6.2.10** Loan with no lender contractual obligation to renew

**Example 6.2.20** Effect of extensions on the contractual term

**Example 6.2.30** Loan with borrower conditional option to extend

**Example 6.2.40** Callable loan

**Example 6.2.50** Weighted-average remaining life

**6.3 [Not used]**

**6.4 Estimating the life of credit card receivables**

6.4.10 Overview

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 6.1 How the standard works

Subtopic 326-20 requires an entity to estimate expected credit losses over a financial asset's contractual term. The contractual term is adjusted for prepayments.

Because expected credit losses are estimated over the contractual term, the determination of the contractual term will generally significantly affect the size of the allowance for credit losses. In general, the longer the contractual term, the larger the allowance for credit losses.

This chapter discusses the effect of the following on a financial asset's contractual term:

- options to extend the contractual term;
- call options; and
- expected prepayments.

It also addresses some specific considerations for estimating the life of credit card receivables and determining the contractual term for net investments in leases.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 6.2 Determining the contractual term

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-6** An entity shall estimate expected credit losses over the contractual term of the financial asset(s) when using the methods in accordance with paragraph 326-20-30-5. An entity shall consider prepayments as a separate input in the method or prepayments may be embedded in the credit loss information in accordance with paragraph 326-20-30-5. An entity shall consider estimated prepayments in the future principal and interest cash flows when utilizing a method in accordance with paragraph 326-20-30-4. An entity shall not extend the contractual term for expected extensions, renewals, and modifications unless the following applies:

a. Subparagraph superseded by Accounting Standards Update No. 2022-02.
b. The extension or renewal options (excluding those that are accounted for as derivatives in accordance with Topic 815) are included in the original or modified contract at the reporting date and are not unconditionally cancellable by the entity.

### 6.2.10 Intention to renew

An entity estimates expected credit losses over the contractual term. The contractual term does not include expected future renewals or extensions. This is the case even if the entity has established a past practice of renewing similar financial assets.

#### **Example 6.2.10** Loan with no lender contractual obligation to renew

Bank provides a one-year, $50,000 bridge loan to Borrower.

Bank has no contractual obligation to extend the bridge loan or to provide a new loan to Borrower at the end of the bridge loan term. However, Bank has a past practice for similar loans of subsequently providing a three-year term loan for the same amount (i.e. $50,000) once the bridge loan matures. Borrower would then use the proceeds from the term loan to pay off the bridge loan.

Although Bank has established a past practice of renewing similar loans, it is not contractually obligated to extend the bridge loan or to provide a new term loan. Therefore, Bank uses the one-year contractual term of the bridge loan to measure expected credit losses.

Additionally, Bank does not recognize a separate liability for any potential off-balance sheet credit exposure because the ability to renew the loan is within its control – i.e. there is no contractual obligation placed on Bank.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 6.2.20 Options to extend the contractual term

Either the borrower or lender may have an option to extend the maturity date of a loan. The lender needs to evaluate the effect of these options on the contractual term over which expected credit losses should be estimated.

If the lender has the unconditional option to extend the contractual term, the lender should not consider the potential extension when determining the contractual term. If the borrower has the contractual option to extend the contractual term, the lender should evaluate whether the potential extension affects the contractual term, unless the lender accounts for the option as a derivative. [326-20-30-6]

### **Example 6.2.20** Effect of extensions on the contractual term

At the beginning of Year 1, Bank provides a three-year loan to Borrower (the maturity date is the end of Year 3). The loan does not contain any extension or renewal options that are not unconditionally cancellable by Bank. Based on historical experience, Bank does not expect Borrower to prepay the loan.

During Year 3, Borrower requests an extension of the original maturity date and the Bank agrees in principle to grant the extension. However, Bank does not enter into an agreement to contractually extend the term until Year 4.

Bank determines the contractual term over which expected credit losses should be estimated. For the Year 3 reporting period, Bank does not consider the potential extension because Borrower does not have the contractual option to extend the loan and Bank has not yet granted the extension by contractually extending the loan's term. Rather, the estimate of expected credit losses is based on the original contractual term of the loan (i.e. three years).

The contractual term is not adjusted as a result of Borrower's request for an extension and Bank agreeing to grant the extension. However, once the extension has been entered into contractually, Bank includes the effect of the extended contractual term when estimating expected credit losses.

### **Question 6.2.10** What is the effect on the contractual term of a borrower's option to extend the maturity date of a funded loan?

**Interpretive response:** A loan may include contractual features that allow the maturity date to be extended at the borrower's option.

***Borrower option outside lender's control***

The borrower's contractual option to extend the maturity date could be unilateral (i.e. unconditional), or it could be conditional upon the occurrence of events outside the lender's control. In either scenario, the lender does not have the ability to avoid extending the maturity date of the loan.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

In these scenarios, the option affects the loan's contractual term and resulting estimate of expected credit losses, unless the option is accounted for as a derivative. The lender should measure the allowance for credit losses by considering the option's expected effects and the likelihood that the borrower will exercise the option. [326-20-30-6]

***Borrower option within lender's control***

If the borrower's ability to exercise the term-extension option is within the lender's control, the lender should not adjust the contractual term of the funded loan or record an off-balance sheet credit exposure because there is no contractual obligation placed on the lender. An example of this type of situation is when a new underwriting is required in connection with the borrower's request for a term-extension. [326-20-30-6]

## **Example 6.2.30** Loan with borrower conditional option to extend

Bank provides a $1,000 one-year loan to Borrower. The loan may be extended for an additional year at Borrower's option if Borrower's external credit rating does not decline, which is a condition outside Bank's control. Bank does not account for the extension option as a derivative.

Bank estimates the probability of default is 2% per year and the loss given default is 65% of the original principal amount. Bank also estimates that there is a 50% likelihood that Borrower will exercise its option – meaning Borrower's credit rating will not decline and Borrower will elect to extend the term of the loan for an additional year.

For the $1,000 loan, Bank calculates its allowance for credit losses as $1,000 × 2% × 65% = $13, representing expected credit losses over the one-year contractual term of the funded loan.

Because Borrower has an option to extend the loan for an additional year, Bank has additional credit exposure for the period covered by the potential extension. Bank calculates its allowance for credit losses as $1,000 × 2% × 65% × 50% = $6.50.

## **Question 6.2.20** What is the effect on the contractual term of a lender's option to extend the maturity date of a funded loan?

**Interpretive response:** A loan may include features that allow the maturity date to be extended at the lender's option.

If the term of the loan may be extended at the lender's option, the contractual term should not include the potential extension(s), even if the lender has a past practice of extending the term. However, once the extension has been entered into contractually, the lender includes the effect of the extended contractual term when estimating expected credit losses. The term is not extended until it

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

is contractually entered into. Additionally, no off-balance sheet credit exposure exists, because there is no contractual obligation placed on the lender.

### **Question 6.2.25** Is it appropriate for an entity to assume that all (or no) extension or renewal options will be exercised?

**Interpretive response:** It depends. In general, we do not believe it is appropriate for an entity to assume that either all (or no) extension or renewal options will be exercised if that assumption does not reflect the entity's historical experience. An exception arises if the entity can demonstrate that the current facts and circumstances have changed from its historical experience in a manner that supports the assumption.

In our experience, many entities do not currently track extension or renewal options and how often these options have been exercised. To prepare for implementation, we believe an entity will need to consider whether and how its estimate of the allowance for credit losses incorporates the credit risk related to these options.

Some entities may need to change their existing processes and related controls to:

- identify whether contracts contain contractual extension or renewal options that are not unconditionally cancellable by the entity – i.e. are not in the lender's control;
- capture information necessary to estimate the likelihood that the renewal or extension option will be exercised, including the likelihood that the contingent events will occur; and
- measure the effect of the potential extension period on the estimate of expected credit losses.

## 6.2.30 Call options

### **Question 6.2.30** What is the effect on the contractual term of a call option held by the lender?

**Interpretive response:** When a financial asset is callable by the lender, we believe the lender should estimate credit losses only for the minimum period that it is contractually exposed to credit losses. This is the period between the reporting date and the date that repayment would become due if the call option were exercised at the earliest possible date. That is, an entity should measure the allowance for credit losses by estimating the expected credit losses that would occur if the entity were to call the loan at the earliest possible date.

For example, if the reporting date is December 31, Year 1 and the lender has an option that is exercisable immediately with repayment due in 12 months, the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

period over which credit losses should be estimated is 12 months. Alternatively, if the option is not exercisable for six months (July 1, Year 2) with repayment due in 12 months from the date of exercise, the period over which credit losses should be estimated is 18 months.

A financial instrument that is callable by the lender at any time is economically equivalent to a loan that is due in the near-term (i.e. in one day) for which the lender has a series of one-day extension options. Therefore, we believe the approach to determining the allowance for credit losses should be similar.

In the past, an entity may not have called all financial assets on their earliest call dates. As a result, the entity may have had a longer period of credit exposure to those financial assets than would be considered under Subtopic 326-20. Therefore, the entity's historical loss experience may not reflect the losses that would have occurred (or not occurred) if the entity had called those assets at their earliest call dates. In this situation, an entity should consider whether its historical loss experience should be adjusted to reflect its estimate of what expected credit losses would have been if the option had been exercised at the earliest call date.

### **Example 6.2.40** Callable loan

Bank provides a $1,000,000 loan to Borrower. Bank may call the loan at any time, and Borrower is given one day to repay the loan in full. However, in practice, Bank only cancels the facility when it becomes aware of a significant deterioration in the credit quality of a borrower.

Bank estimates the allowance for credit losses over the minimum period that it is exposed to credit losses. In this case, Bank assumes it would immediately exercise its option, and that Borrower would then have one day to repay the loan.

Bank estimates that if the loan were called immediately there would be a 0.5% chance that Borrower would not be able to pay the outstanding balance the following day. Bank also estimates that the loss given default would be 30% of the original principal amount. For the $1,000,000 loan, Bank calculates its allowance for credit losses as $1,000,000 × 0.5% × 30% = $1,500.

## 6.2.40 Expected prepayments

The contractual term of a loan must be adjusted for expected prepayments. [326-20-30-6]

### **Question 6.2.40** May the weighted-average remaining life be used as the contractual term for a portfolio of loans?

**Interpretive response:** It depends. When estimating prepayments for a portfolio of loans, we believe there are several challenges that should be

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

addressed before using the weighted-average remaining life as a simplifying assumption for the remaining duration of a portfolio of financial assets. For example, this assumption may be challenging to sustain when loan losses are expected to occur at significantly different times or at different rates over the contractual term of the loans rather than on a ratable basis, as illustrated in Example 6.2.50.

When loss rates are expected to be reasonably consistent over the contractual term of a financial asset, an entity may have a greater ability to use the weighted-average life as a simplifying assumption. In other circumstances, we believe practices may develop whereby simplifying assumptions such as weighted-average remaining lives will be used in quantitative models, and then qualitative adjustments will be made to the allowance for credit losses to compensate for the effect of the simplifying assumptions. However, the benefit from simplifying the quantitative model may be offset by the complexity of developing and supporting the amount of the qualitative adjustments.

The FASB staff issued a Q&A document that addresses issues related to the weighted-average remaining maturity method for estimating the allowance for credit losses. The FASB staff indicated that the weighted-average remaining maturity method is one of many methods that could be used to estimate an allowance for credit losses for less complex financial asset pools, and that an entity needs to consider whether qualitative adjustments should be made. [FASB Staff Q&A]

## **Example 6.2.50** Weighted-average remaining life

ABC Corp. has a portfolio of three newly originated five-year loans that are each prepayable. Loan #1 is expected to be prepaid in Year 1, Loan #2 is expected to be prepaid in Year 3 and Loan #3 is not expected to be prepaid. Because the amortized cost of each loan is $2,000,000, the weighted-average life of the portfolio is three years after considering prepayments. ABC expects different loss rates throughout the five-year contractual term.

This example is intended to illustrate the potential effect of using the weighted-average remaining life as a simplifying assumption when estimating credit losses. Specifically, it illustrates how the allowance for credit losses differs when ABC uses different loss rates for each loan in the portfolio based on each loan's expected prepayment date, and when it bases its loss rate on a simplifying assumption that all loans in the portfolio will prepay on the same date – i.e. assuming that the remaining term for all loans equals the weighted-average maturity date for the overall portfolio.

***Calculation of expected credit losses using contractual term and loss rates determined for each loan***

| Loan | Amortized cost | Prepayment expected after __ years | Cumulative loss rate | Expected credit losses |
|---|---|---|---|---|
| 1 | 2,000,000 | 1 | 2.50% | 50,000 |
| 2 | 2,000,000 | 3 | 4.50% | 90,000 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Loan | Amortized cost | Prepayment expected after __ years | Cumulative loss rate | Expected credit losses |
|---|---|---|---|---|
| 3 | 2,000,000 | 5 | 5.00% | 100,000 |
| Total | 6,000,000 | | 4.00%[1] | 240,000 |

Note:
1. This is the weighted-average loss rate for the portfolio, calculated as $240,000 ÷ $6,000,000.

***Calculation of expected credit losses using the weighted-average life as the remaining term for all loans in the portfolio***

| Loan | Amortized cost | Prepayment expected after __ years | Cumulative loss rate | Expected credit losses |
|---|---|---|---|---|
| Pool | 6,000,000 | 3 | 4.50%[1] | 270,000 |

Note:
1. The weighted-average remaining life of the loan portfolio is three years. Because this approach assumes that all loans will prepay in three years, the loss rate for loans with an expected prepayment date of three years (4.50%) is applied to the entire portfolio.

***Comparison of estimated expected credit losses***

| Calculated based on: | Expected credit losses |
|---|---|
| Using the contractual term and loss rates determined for each loan | 240,000 |
| Using weighted-average life as the remaining term for all loans in the portfolio | 270,000 |
| Difference | 30,000 |

Because different loss rates are expected throughout the contractual term of the portfolio, if the weighted-average life is used for the remaining duration of the entire portfolio, qualitative adjustments need to be made to the allowance to compensate for the effect of the simplifying assumption. As mentioned in Question 6.2.40, the benefit obtained by the entity from simplifying the quantitative model may be offset by the complexity of developing and supporting the qualitative adjustments.

## **Question 6.2.50** Must a lender use the loan modification guidance to determine whether a refinancing should be considered a prepayment?

**Background:** Paragraphs 310-20-35-9 to 35-12 provide guidance that a lender uses to determine whether a refinancing results in recognition of a new loan or a continuation of the existing loan (i.e. a loan modification).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Interpretive response:** No. The TRG and FASB discussed this issue at meetings in June and August 2018, respectively. They agreed that an entity is permitted (but not required) to consider the guidance in paragraphs 310-20-35-9 to 35-12 when determining what constitutes a prepayment for purposes of estimating expected credit losses. [TRG 2018-06.12, TRG 2018-06.13]

The FASB decided that an entity should use judgment to develop an approach that faithfully reflects expected credit losses for financial assets and can be applied consistently over time. This includes applying judgment when identifying the appropriate methods and inputs (including prepayments) to be used. However, this judgment may differ for different loan types. [TRG 2018-06.12, TRG 2018-06.13]

For example, an entity may have a refinancing that results in recognizing a new loan under the guidance in paragraphs 310-20-35-9 to 35-12. An entity is permitted to only consider such a refinancing as a prepayment for purposes of estimating the contractual term under Subtopic 326-20. [TRG 2018-06.12, TRG 2018-06.13]

Because Subtopic 326-20 requires prepayments to be considered in estimating a financial asset's contractual term, an entity needs to develop processes and controls to estimate prepayments. This encompasses estimating refinancing activity based on the entity's approach for determining whether refinancings are considered prepayments.

## **Question 6.2.60** Are reasonable and supportable forecasts of future economic conditions considered in developing a prepayment assumption?

**Interpretive response:** Yes. In developing its prepayment assumption, we believe an entity should not rely solely on historical experience but should also consider its reasonable and supportable forecast of economic conditions. For example, forecasted changes in interest rates or other economic conditions may impact expected prepayments. The estimate of prepayments will affect the life of the financial asset and therefore the amount of losses an entity includes in its estimate of expected credit losses.

This approach is consistent with how an entity considers reasonable and supportable forecasts of future economic conditions in developing other aspects of the allowance for expected credit losses, including the probability of default and the loss given default assumptions. [326-20-30-9]

See section 7.3.10 for additional information on reasonable and supportable forecasts.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 6.2.70** Can an entity assume that prepayments will occur at a constant rate over the remaining contractual term?

**Interpretive response:** It depends. Estimating the contractual term of a portfolio of prepayable financial assets requires an entity to estimate both the magnitude of prepayments and the timing of those prepayments.

In some circumstances, an entity may conclude that a constant prepayment rate represents its best estimate of the timing of prepayments. In that case, we believe the use of a constant prepayment rate is appropriate.

In other circumstances, an entity may conclude that a constant prepayment rate does not represent its best estimate of the timing of prepayments. In such cases, we believe an entity should either:

- incorporate a non-constant prepayment assumption that reflects its best estimate of the timing of prepayments; or
- use a constant prepayment rate as a simplifying assumption in the quantitative model, along with qualitative adjustments made to the allowance for credit losses to compensate for the effect of the simplifying assumption. However, the benefit of simplifying the quantitative model may be offset by the complexity of developing and supporting the amount of the corresponding qualitative adjustments.

For example, an entity owns a portfolio of residential mortgage loans. It evaluates the expected timing of prepayments using its own experience and available external information; as a result, it determines that its best estimate is not a constant prepayment rate but rather that prepayment rates will be lower in the earlier portion of the contractual term and higher in the later portion of the contractual term. In this example, the entity should either:

- incorporate an assumption in the quantitative model that prepayment rates will be lower in the earlier portion of the contractual term and higher in the later portion of the contractual term; or
- follow a two-step approach by:
  - using a simplifying assumption that prepayments will occur evenly over the remaining contractual term in the quantitative model; and
  - developing a qualitative adjustment to adjust the quantitative model for the estimated effect of using the simplifying assumption.

## 6.4 Estimating the life of credit card receivables

### 6.4.10 Overview

For most credit card relationships, Subtopic 326-20 requires an entity to estimate the allowance for credit losses for only the balance existing at the reporting date. An allowance for credit losses is generally not recognized for the amounts that are expected to be drawn in the future because they are typically

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

unconditionally cancellable by the entity. This adds complexity to the estimate of the remaining life of a credit card receivable because an entity needs to determine whether expected future principal payments will relate to the reporting date balance or balances arising after the reporting date (i.e. future drawdowns).

The TRG discussed how to allocate expected future payments between the reporting date balance and balances expected to arise after the reporting date. Specifically, the TRG clarified that an entity is permitted but not required to apply expected principal payments to the credit card receivable balances existing at the reporting date until the balance is exhausted. Alternatively, an entity could choose other methods that allocate expected principal payments between the balance existing at the reporting date and future balances. The TRG noted that different approaches will result in different estimates of expected credit losses. [326-20-30-6, TRG 06-17.5, TRG 06-17.6]

Some TRG members raised questions about how future principal payment amounts should be determined when an entity elects to allocate those payments to the credit card receivables balance existing at the reporting date until the balance is exhausted. In an October 2017 FASB meeting, the Board discussed how to determine estimated expected future payments.

Consistent with the flexibility provided in other aspects of measuring expected credit losses, the Board decided that a specific approach would not be required. Instead, an entity may:

- include all payments expected to be collected from the borrower;
- include a portion of the payments expected to be collected from the borrower; or
- apply a different approach.

The Board noted that the approach selected should be consistent with the objectives of the standard.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 7. Historical loss experience, forecasts and reversion

## Detailed contents

Item significantly updated in this edition: #

**7.1 How the standard works**

**7.2 Historical loss experience**

7.2.10 Overview

7.2.20 Source(s) of historical information

7.2.30 Selecting historical period(s)

**Questions**

**Question 7.2.10** Under what circumstances may an entity use external data?

**Question 7.2.20** Must an entity select a historical period that represents its expectation for future periods?

**Question 7.2.30** May an entity base its selection of a historical loss period on an economic outlook that extends further than its reasonable and supportable forecast period?

**7.3 Adjusting historical loss information**

7.3.10 Overview

7.3.20 Determining the reasonable and supportable forecast period

7.3.30 Reversion to historical loss information

**Questions**

**Question 7.3.10** What types of adjustments are required or precluded during and after the reasonable and supportable forecast period?

**Question 7.3.12** Is an adjustment for differences in asset-specific risk characteristics made for the remaining contractual term for all assets held?

**Question 7.3.13** Does an entity consider anticipated changes in laws and regulations when estimating expected credit losses?

**Question 7.3.15** Must an entity consider multiple economic scenarios when developing its economic forecast?#

**Question 7.3.16** May an entity include the effect of multiple economic scenarios through a qualitative adjustment?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 7.3.20** May an entity assert that it cannot develop any economic forecasts and rely solely on historical losses?

**Question 7.3.25** Is the reasonable and supportable forecast period determined based on an entity's ability to make or obtain forecasts of future economic conditions?

**Question 7.3.30** May the length of the reasonable and supportable forecast period differ for different economic assumptions?

**Question 7.3.40** Is a statistical confidence level required to support the length of the reasonable and supportable forecast period?

**Question 7.3.50** Is 'backtesting' the historical accuracy of the forecasting process required to substantiate whether a current period forecast is reasonable and supportable?

**Question 7.3.60** Must an entity reevaluate the reasonable and supportable forecast period?

**Question 7.3.70** Should there be consistency between economic forecasts used for estimating expected credit losses and other purposes?

**Question 7.3.75** Does an entity include 'qualitative' adjustment(s) in its estimate of expected credit losses?

**Question 7.3.77** Can a reversion-like approach be used to develop a forecast of future economic conditions during the reasonable and supportable forecast period?

**Question 7.3.80** How is the reasonable and supportable forecast period determined when reversion is based on the entire estimate?

**Question 7.3.90** Is the reversion method a practical expedient?

**Question 7.3.100** May an entity revert to historical loss experience over a period shorter than the remaining contractual term of the financial assets?

**Question 7.3.110** Can a reversion method effectively incorporate economic forecasts?

### Examples

**Example 7.3.02** Adjustments for asset-specific risk characteristics – change in lending management

**Example 7.3.03** Anticipated changes in laws and regulations – change in collection practices

**Example 7.3.05** Multiple vs single scenario approaches for economic forecasts#

**Example 7.3.10** Adjusting for differences in asset-specific risk characteristics and economic conditions

**Example 7.3.15** Qualitative adjustment to reflect changes in underwriting standards

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Example 7.3.16** Qualitative adjustment to reflect changes in collateral value

**Example 7.3.20** Reversion at input level

**Example 7.3.30** Reversion based on the entire estimate

**Example 7.3.40** Applying immediate and straight-line reversion

## 7.4 FASB examples

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

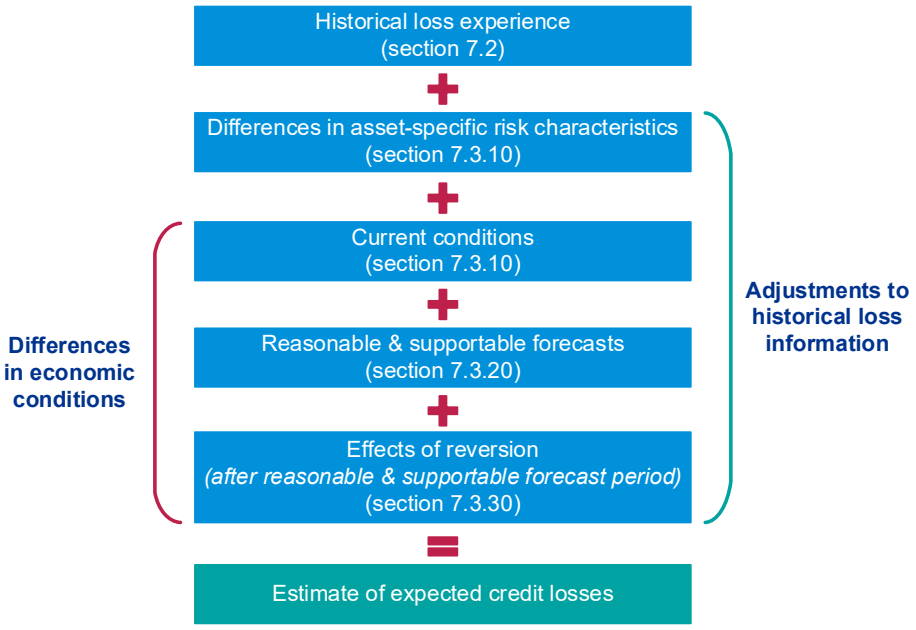
## 7.1 How the standard works

The estimate of expected credit losses is based on relevant information about past events, current economic conditions, and reasonable and supportable forecasts of future economic conditions that affect the collectibility of the reported amounts. Historical loss experience is generally the starting point for estimating expected credit losses.

Adjustments are made to historical loss experience to reflect:

- differences in asset-specific risk characteristics – e.g. underwriting standards, portfolio mix or asset terms.
- differences in economic conditions – both current conditions and reasonable and supportable forecasts of future economic conditions. If an entity is not able to make or obtain reasonable and supportable forecasts of future economic conditions for the entire life of the financial asset, it is required to estimate expected credit losses for the remaining life using an approach that reverts to historical credit loss information.

The following diagram summarizes the concepts discussed in this chapter.




© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 7.2 Historical loss experience

## 7.2.10 Overview

### Excerpt from ASC 326-20

> Historical Loss Experience

**30-7** When developing an estimate of expected credit losses on financial asset(s), an entity shall consider available information relevant to assessing the collectibility of cash flows. This information may include internal information, external information, or a combination of both relating to past events, current conditions, and reasonable and supportable forecasts. An entity shall consider relevant qualitative and quantitative factors that relate to the environment in which the entity operates and are specific to the borrower(s). When financial assets are evaluated on a collective or individual basis, an entity is not required to search all possible information that is not reasonably available without undue cost and effort. Furthermore, an entity is not required to develop a hypothetical pool of financial assets. An entity may find that using its internal information is sufficient in determining collectibility.

**30-8** Historical credit loss experience of financial assets with similar risk characteristics generally provides a basis for an entity's assessment of expected credit losses. Historical loss information can be internal or external historical loss information (or a combination of both). An entity shall consider adjustments to historical loss information for differences in current asset specific risk characteristics, such as differences in underwriting standards, portfolio mix, or asset term within a pool at the reporting date or when an entity's historical loss information is not reflective of the contractual term of the financial asset or group of financial assets.

• > Information Considered When Estimating Expected Credit Losses

**55-2** In determining its estimate of expected credit losses, an entity should evaluate information related to the borrower's creditworthiness, changes in its lending strategies and underwriting practices, and the current and forecasted direction of the economic and business environment. This Subtopic does not specify a particular methodology to be applied by an entity for determining historical credit loss experience. That methodology may vary depending on the size of the entity, the range of the entity's activities, the nature of the entity's **financial assets**, and other factors.

**55-3** Historical loss information generally provides a basis for an entity's assessment of expected credit losses. An entity may use historical periods that represent management's expectations for future credit losses. An entity also may elect to use other historical loss periods, adjusted for current conditions, and other reasonable and supportable forecasts. When determining historical loss information in estimating expected credit losses, the information about historical credit loss data, after adjustments for current conditions and reasonable and supportable forecasts, should be applied to pools that are defined in a manner that is consistent with the pools for which the historical credit loss experience was observed.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

An entity bases its estimate of expected credit losses on relevant information about past events, current conditions, and reasonable and supportable forecasts that affect the collectibility of the financial asset. [326-20-30-7]

Historical loss experience generally serves as the starting point for this estimate. An entity uses its judgment in selecting: [326-20-30-8]

- source(s) of historical information (see section 7.2.20); and
- historical period(s) to use for obtaining historical loss experience (see section 7.2.30).

Historical loss information should be separately determined for each of the asset pools for which expected credit losses are being estimated. Moreover, the level at which historical loss information is developed should be consistent with the level of pooling elected by the entity. [326-20-55-3]

## 7.2.20 Source(s) of historical information

An entity may use internal and/or external historical loss information when estimating expected credit losses. However, the FASB indicated that an entity should not default to using only the most observable external data if its internal data is sufficient. Additionally, while an entity should not ignore relevant data when considering historical loss information, it is not required to search for information that is not reasonably available without undue cost and effort. [ASU 2016-13.BC51]

### **Question 7.2.10** Under what circumstances may an entity use external data?

**Interpretive response:** In selecting source(s) of historical information, we believe an entity should begin by determining whether internal data is available that is relevant and reliable. We believe an entity may elect to use external data when limitations exist on the availability of internal data or when external data has been determined to be more relevant and/or reliable. However, an entity should place more emphasis on its internal data if that data is (or subsequently becomes) more relevant and reliable than the external data.

There may be circumstances where relevant and reliable internal data is not reasonably available for historical periods without undue cost or effort. If an entity decides it would not be beneficial to undertake efforts to gather internal historical data – e.g. because certain data is not available or is not accessible from its information systems – we believe it should begin to capture and maintain this information for use in future periods. Until an entity has developed sufficient internal data, relevant and reliable external information may be used. [Agency FAQ #26]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 7.2.30 Selecting historical period(s)

### Excerpt from ASC 326-20

• > Developing an Estimate of Expected Credit Losses

**55-6** Estimating expected credit losses is highly judgmental and generally will require an entity to make specific judgments. Those judgments may include any of the following:

a. The definition of default for default-based statistics
b. The approach to measuring the historical loss amount for loss-rate statistics, including whether the amount is simply based on the amortized cost amount written off and whether there should be adjustments to historical credit losses (if any) to reflect the entity's policies for recognizing accrued interest
c. The approach to determine the appropriate historical period for estimating expected credit loss statistics
d. The approach to adjusting historical credit loss information to reflect current conditions and reasonable and supportable forecasts that are different from conditions existing in the historical period
e. The methods of utilizing historical experience
f. The method of adjusting loss statistics for recoveries
g. How expected prepayments affect the estimate of expected credit losses
h. How the entity plans to revert to historical credit loss information for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses
i. The assessment of whether a financial asset exhibits risk characteristics similar to other financial assets.

**55-7** Because of the subjective nature of the estimate, this Subtopic does not require specific approaches when developing the estimate of expected credit losses. Rather, an entity should use judgment to develop estimation techniques that are applied consistently over time and should faithfully estimate the collectibility of the financial assets by applying the principles in this Subtopic. An entity should utilize estimation techniques that are practical and relevant to the circumstance. The method(s) used to estimate expected credit losses may vary on the basis of the type of financial asset, the entity's ability to predict the timing of cash flows, and the information available to the entity.

Subtopic 326-20 does not provide prescriptive guidance about what historical period should be used for obtaining historical loss experience – e.g. a full credit cycle, recent experience or a historical period that is representative of the expected conditions in the future. Instead, it indicates that the estimate of expected credit losses generally requires an entity to make specific judgments, including the approach used to determine the historical period. Different approaches may lead to diversity in practice. [326-20-55-3, 55-6 – 55-7]

Once an entity has selected a historical period, it needs to adjust the historical loss information for current conditions and reasonable and supportable forecasts – as well as for asset-specific risk characteristics.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Therefore, all of the following items are inputs into the estimate of expected credit losses:

- the unadjusted historical loss information;
- adjustments for asset-specific risk characteristics;
- adjustments for current conditions;
- adjustments for reasonable and supportable forecasts; and
- reversion to historical loss information for periods during which reasonable and supportable forecasts are not available.

Section 7.3 explains how and when to make these adjustments and when to revert to historical loss information.

The historical period selected may be a more significant input to the estimate of expected credit losses when an entity cannot make or obtain reasonable and supportable forecasts over the entire contractual term of the financial asset. This is because the historical credit loss experience from the selected historical period serves as the basis for estimating expected credit losses for periods beyond the reasonable and supportable forecast period, and therefore has a greater effect on the estimate in those circumstances. [326-20-30-9]

Regardless of the period used, an entity should evaluate whether the selected period, in combination with other assumptions and adjustments, results in the best estimate of expected credit losses.

See also Question 7.3.30 regarding supporting documentation for the selection of the historical period(s) as compared to supporting documentation for the reasonable and supportable forecasts.

## **Question 7.2.20** Must an entity select a historical period that represents its expectation for future periods?

**Interpretive response:** When obtaining historical loss information, Subtopic 326-20 permits (but does not require) an entity to use historical periods that represent management's expectation of future credit losses. [326-20-55-3]

This allows an entity to use, as a starting point, the period that it believes is most consistent with its forward-looking expectations – taking into account both (1) expected future economic conditions, and (2) similarities and differences regarding the risk characteristics of the financial assets themselves.

An entity may find it beneficial to use the period that it believes is most consistent with its forward-looking expectations because it may reduce the number and/or magnitude of required adjustments that need to be made.

However, it may be difficult to determine which periods to use when there are conflicting factors. For example, factors such as attributes of the financial asset will likely be most similar in recent periods. But management's expectations about future economic conditions may be most similar to a period further in the past. Accordingly, an entity will need to exercise judgment in selecting the historical period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 7.2.30** May an entity base its selection of a historical loss period on an economic outlook that extends further than its reasonable and supportable forecast period?

**Interpretive response:** Yes. Subtopic 326-20 specifically permits an entity to use historical periods that represent management's expectations for future credit losses. In making this selection, we believe that an entity could use an economic outlook that extends further than its reasonable and supportable forecast period.

For example, an entity may be able to demonstrate an understanding of the current point in the economic cycle and develop its best estimate of expected credit losses using historical loss experience that reflects an improving or deteriorating point in an economic cycle based on that understanding. However, despite its ability to select a historical loss period that represents its expected future conditions, it may be unable to develop reasonable and supportable forecasts for certain inputs beyond a certain period. In those future periods for which it is unable to develop reasonable and supportable forecasts, the entity reverts to the historical loss experience and does not make further adjustments to that experience based on its expectations for future economic conditions.

However, if an entity reverts to a historical loss period that represents its expectations of future economic conditions, both the specific period chosen by the entity and the economic outlook used in the determination should be supported by documentation and analysis. We believe the nature and extent of documentation supporting the selection of the period used to determine the historical loss experience – which is the information to which the estimate of expected credit losses reverts – will be different than the documentation needed for reasonable and supportable forecasts.

## 7.3 Adjusting historical loss information

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-9** An entity shall not rely solely on past events to estimate expected credit losses. When an entity uses historical loss information, it shall consider the need to adjust historical information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated. The adjustments to historical loss information may be qualitative in nature and should reflect changes related to relevant data (such as changes in unemployment rates, property values, commodity values, delinquency, or other factors that are associated with credit losses on the financial asset or in the group of financial assets). Some entities may be able to develop reasonable and supportable forecasts over the contractual term of the financial asset or a group of financial assets. However,

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

an entity is not required to develop forecasts over the contractual term of the financial asset or group of financial assets. Rather, for periods beyond which the entity is able to make or obtain reasonable and supportable forecasts of expected credit losses, an entity shall revert to historical loss information determined in accordance with paragraph 326-20-30-8 that is reflective of the contractual term of the financial asset or group of financial assets. An entity shall not adjust historical loss information for existing economic conditions or expectations of future economic conditions for periods that are beyond the reasonable and supportable period. An entity may revert to historical loss information at the input level or based on the entire estimate. An entity may revert to historical loss information immediately, on a straight-line basis, or using another rational and systematic basis.

• > Information Considered When Estimating Expected Credit Losses

**55-4** Because historical experience may not fully reflect an entity's expectations about the future, management should adjust historical loss information, as necessary, to reflect the current conditions and reasonable and supportable forecasts not already reflected in the historical loss information. In making this determination, management should consider characteristics of the financial assets that are relevant in the circumstances. To adjust historical credit loss information for current conditions and reasonable and supportable forecasts, an entity should consider significant factors that are relevant to determining the expected collectibility. Examples of factors an entity may consider include any of the following, depending on the nature of the asset (not all of these may be relevant to every situation, and other factors not on the list may be relevant):

a. The borrower's financial condition, credit rating, credit score, asset quality, or business prospects
b. The borrower's ability to make scheduled interest or principal payments
c. The remaining payment terms of the financial asset(s)
d. The remaining time to maturity and the timing and extent of prepayments on the financial asset(s)
e. The nature and volume of the entity's financial asset(s)
f. The volume and severity of past due financial asset(s) and the volume and severity of adversely classified or rated financial asset(s)
g. The value of underlying collateral on financial assets in which the collateral-dependent practical expedient has not been utilized
h. The entity's lending policies and procedures, including changes in lending strategies, underwriting standards, collection, writeoff, and recovery practices, as well as knowledge of the borrower's operations or the borrower's standing in the community
i. The quality of the entity's credit review system
j. The experience, ability, and depth of the entity's management, lending staff, and other relevant staff
k. The environmental factors of a borrower and the areas in which the entity's credit is concentrated, such as:
    1. Regulatory, legal, or technological environment to which the entity has exposure
    2. Changes and expected changes in the general market condition of either the geographical area or the industry to which the entity has exposure

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

3. Changes and expected changes in international, national, regional, and local economic and business conditions and developments in which the entity operates, including the condition and expected condition of various market segments.

## 7.3.10 Overview

Historical loss information generally provides a starting point for the estimate of expected credit losses. An entity considers whether adjustments are needed for differences between the historical period chosen by the entity and its forward-looking estimates.

As noted in section 7.2, Subtopic 326-20 does not indicate the historical period that should be selected and instead requires an entity to use judgment in making its selection. Once an entity selects a historical period, it should consider the need for any adjustments to the period's historical loss information.

Subtopic 326-20 describes three types of adjustments to historical credit losses. [326-20-30-8 – 30-9, 55-4]

| Type of adjustment | Description |
|---|---|
| **For current asset-specific risk characteristics** | Adjustments intended to capture differences between the assets existing at the reporting date and the assets included in the historical credit loss experience.<br>For example, an entity may need to adjust the historical loss experience for differences in underwriting standards, changes in the portfolio mix or changes in the contractual terms of the assets. [326-20-30-8, 55-4] |
| **For current conditions** | Adjustments for external economic factors at the reporting date that did not exist over the period from which historical experience was used. |
| **For reasonable and supportable forecasts** | Adjustments for external economic factors that are expected to be different in future periods and are not already reflected in the historical loss experience. For periods beyond the reasonable and supportable forecast period, an entity reverts to historical loss information using a reversion method. See sections 7.3.20 and 7.3.30. |

### **Question 7.3.10** What types of adjustments are required or precluded during and after the reasonable and supportable forecast period?

**Interpretive response:** We believe that whether adjustments for differences in asset-specific risk characteristics and economic conditions are required to be made – or are precluded from being made – depends on the nature of the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

differences and whether an entity is able to make or obtain reasonable and supportable forecasts of economic conditions. [326-20-30-8 – 30-9]

| Nature of differences as compared to historical loss information | Periods that an entity can reasonably and supportably forecast economic conditions | Periods that an entity *cannot* reasonably and supportably forecast economic conditions |
|---|---|---|
| **Differences in asset-specific risk characteristics (e.g. underwriting or loan terms)** | Adjustment required (see Question 7.3.12) | Adjustment required (see Question 7.3.12) |
| **Differences in economic conditions, both current conditions and expectations for future conditions** | Adjustment required | Adjustment prohibited (other than the effects of reversion) |

If an entity asserts that it is unable to make or obtain a reasonable and supportable forecast of future economic conditions beyond a certain point in time, there is no basis to determine what economic adjustments should be made in those periods. Therefore, for periods beyond the reasonable and supportable forecasts, an entity uses the historical credit loss information – adjusted for asset-specific risk characteristics and the effect of the reversion method (see section 7.3.30) – without further adjustments for future economic conditions.

When an entity determines the adjustments to historical loss experience for asset-specific risk characteristics, it needs to avoid inadvertently reflecting differences in economic conditions in that adjustment. This is to avoid inadvertently: [326-20-30-8 – 30-9]

- double-counting the effect of differences in economic conditions during the reasonable and supportable forecast period. The entity ensures those differences are not reflected in an adjustment for differences in economic conditions during the reasonable and supportable forecast period and also in an adjustment for asset-specific risk characteristics; and/or
- making adjustments for economic conditions for periods beyond the reasonable and supportable forecast period (prohibited other than the effects of reversion).

Adjustments for differences in asset-specific risk characteristics and economic conditions may be made in an entity's quantitative model or reflected through a qualitative adjustment (see Question 7.3.75).

## **Example 7.3.02** Adjustments for asset-specific risk characteristics – change in lending management

Bank is estimating expected credit losses for similar loans that each have a remaining contractual term of three years and Bank's reasonable and supportable forecast period is two years.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Bank recently hired a new Chief Credit Officer, who is tasked with aggressively growing the loan portfolio, and is making changes in lending management to further that objective. Bank has determined that this change in lending management resulted in less stringent underwriting standards, which Bank expects to affect credit losses over the entire contractual term of loans originated since the CCO was hired.

Bank makes an adjustment for the remaining three-year contractual term for those loans originated since the new CCO was hired, even though that extends beyond the two-year reasonable and supportable forecast period.

## **Question 7.3.12** Is an adjustment for differences in asset-specific risk characteristics made for the remaining contractual term for all assets held?

**Interpretive response:** Not necessarily. An adjustment for differences in asset-specific risk characteristics should be made for the specific timeframe to which the identified incremental risk applies. Further, those adjustments should be made only to assets affected by the difference, which may be less than all assets for which expected credit losses are measured.

## **Question 7.3.13** Does an entity consider anticipated changes in laws and regulations when estimating expected credit losses?

**Interpretive response:** Yes. We believe an entity should consider anticipated changes in laws and regulations when estimating expected credit losses. Examples of laws and regulations that could affect credit losses include (1) laws (or regulations) that limit the frequency and/or manner in which an entity pursues borrowers to collect delinquent accounts and (2) regulations that affect an entity's ability to foreclose on collateral.

## **Example 7.3.03** Anticipated changes in laws and regulations – change in collection practices

Bank is estimating expected credit losses for unsecured consumer loans with original terms of three to five years. Bank employs collection agents to contact borrowers when accounts are past due and request payment. Current regulations prohibit debt collectors from contacting a borrower more than seven times within a week to pursue collection of a debt.

During the reporting period, the regulatory agency proposes a rule change to reduce the number of calls a debt collector may make to a debtor to four calls per week.

Bank determines that daily collection attempts have a significant impact on collection of past due balances. Therefore, it anticipates expected credit losses

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

will increase for accounts that become past due if (or when) the proposed rule takes effect. Bank assesses the likelihood that the proposed rule will become effective, and incorporates that assessment into the estimate of expected credit losses in the current reporting period.

## **Question 7.3.15** Must an entity consider multiple economic scenarios when developing its economic forecast?#

**Interpretive response:** No. Subtopic 326-20 does not provide specific guidance on how to consider economic factors, including: [ASU2016-13.BC67–BC68]

- whether a single or multiple forward-looking economic scenarios should be used; or
- how to incorporate multiple forward-looking economic scenarios.

Therefore, an entity may use either a single or multiple forward-looking economic scenarios when developing its economic forecast that it will use to adjust historical loss information. An entity should use the method that, in combination with other assumptions and adjustments, results in its best estimate of expected credit losses.

When a single-scenario approach is used, we believe an entity may use either:

- the 'most likely scenario' – i.e. the scenario that is most likely to occur; or
- the 'equally likely scenario' – i.e. the scenario at which the entity believes it is equally likely that economic conditions will be more favorable or less favorable than the economic conditions used in its forecast.

A multiple-scenarios approach generally involves identifying specific economic scenarios, the credit losses expected in each scenario, and the likelihood of each scenario occurring. When an entity uses this approach, we believe the allowance for credit losses should reflect the possibility that credit losses may be worse or may be better than the losses estimated under either of the two types of scenarios in the single-scenario approach. An entity reflects these possibilities through at least one scenario that is more favorable and at least one that is less favorable than either of the permissible scenarios under the single-scenario approach. See also Question 7.3.16, which explains that an entity may include the effect of multiple economic scenarios through a qualitative adjustment.

Further, we believe an entity generally should disclose whether it uses a single or multiple forward-looking economic scenarios as part of the disclosures about its methodology for estimating the allowance for credit losses. See disclosure requirements in chapter 24. [326-20-50-10 – 50-11]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 7.3.05** Multiple vs single scenario approaches for economic forecasts#

Bank determines it should adjust its historical loss information for changes in unemployment rates to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from those in the selected historical period.

The following table reflects management's expectations about future unemployment rates and credit losses that it expects for each scenario.

| Scenario | Forecasted unemployment rate | Expected credit losses | Likelihood of scenario |
|---|---|---|---|
| 1 Most favorable | 4% | 10 | 15% |
| 2 | 5% | 30 | 30% |
| 3 | 6% | 70 | 10% |
| 4 | 7% | 100 | 25% |
| 5 Worst (recession) | 8% | 170 | 20% |

***Single-scenario approach – 'equally likely' scenario***

Under this approach, expected credit losses are $70. This reflects the expected credit losses associated with Scenario 3, which is 10% likely but reflects the scenario for which it is equally likely that economic conditions will be more favorable or less favorable than the economic conditions used in the entity's forecast.

Bank also considers whether $70 reflects its best estimate of expected credit losses, in combination with other assumptions and adjustments.

***Single-scenario approach – 'most likely' scenario***

Under this approach, expected credit losses are $30. This reflects the expected credit losses associated with the scenario that is most likely – i.e. Scenario 2, which at 30% likely represents the scenario with the highest likelihood among the evaluated scenarios.

Bank also considers whether $30 reflects its best estimate of expected credit losses, in combination with other assumptions and adjustments.

***Multiple-scenario approach***

Under this approach, expected credit losses are $76.50, determined as follows.

| Scenario | Forecasted unemployment rate | Expected credit losses | Likelihood of scenario | Probability-weighted expected credit losses[1] |
|---|---|---|---|---|
| 1 Most favorable | 4% | 10 | 15% | 1.50 |
| 2 | 5% | 30 | 30% | 9.00 |
| 3 | 6% | 70 | 10% | 7.00 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Scenario | Forecasted unemployment rate | Expected credit losses | Likelihood of scenario | Probability-weighted expected credit losses[1] |
|---|---|---|---|---|
| 4 | 7% | 100 | 25% | 25.00 |
| 5 Worst (recession) | 8% | 170 | 20% | 34.00 |
| Total | | | | 76.50 |

Note:
1. Expected credit losses × likelihood of scenario.

The scenarios included provide for at least one scenario that is more favorable and one that is less favorable as compared to the scenarios that would have been selected under the single-scenario approaches.

Bank also considers whether $76.50 reflects its best estimate of expected credit losses, in combination with other assumptions and adjustments.

## **Question 7.3.16** May an entity include the effect of multiple economic scenarios through a qualitative adjustment?

**Interpretive response:** Yes. Subtopic 326-20 does not specify how an entity should incorporate its consideration of multiple economic scenarios into its estimate of expected credit losses. As a result, we believe an entity may use a qualitative adjustment to include the effect of multiple scenarios in its estimate of expected credit losses.

For example, assume an entity uses a quantitative model for determining the effect of differences in forecasted economic conditions as compared to historical loss information. The entity may determine those effects by including in the quantitative model:

- multiple economic scenarios; or
- a single economic scenario and separately adjusting the model's output for the effect of scenarios not included in the model – i.e. a 'qualitative adjustment' (see Question 7.3.75).

As discussed in Question 7.3.15, we believe that when an entity uses multiple forward-looking economic scenarios, the allowance for credit losses should include at least one scenario that is more favorable and at least one that is less favorable than either of the two types of scenarios in the single scenario approach. This is the case even if an entity reflects scenarios other than the single scenario through a qualitative adjustment.

If an entity makes a qualitative adjustment to incorporate the effects of economic scenarios not included in the quantitative model, it needs to ensure those effects relate solely to the reasonable and supportable forecast period. As discussed in Question 7.3.10, an entity does not adjust historical loss information for existing economic conditions or expectations of future economic

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

conditions for periods that are beyond the reasonable and supportable forecast period. This is the case regardless of whether the effect of multiple economic scenarios is included in the entity's quantitative model or through a separate qualitative adjustment. [326-20-30-9]

## 7.3.20 Determining the reasonable and supportable forecast period

Estimating expected credit losses under Subtopic 326-20 requires an entity to consider the effect of forecasted future economic conditions.

The reasonable and supportable forecast period relates to the entity's ability to forecast external economic conditions over a financial asset's entire contractual term. However, as the length of time increases, there will be circumstances in which relevant, detailed inputs will not be available to support those forecasts. Whether an entity is able to forecast over a financial asset's entire contractual term is influenced by the source(s) of information used to develop the forecast and, more specifically, the period covered by that information.

Subtopic 326-20 does not provide guidance on determining whether a forecast is reasonable and supportable. We believe there are no bright lines in making this determination and significant judgment may be required. Instead, the length of the period is a judgmental determination based on the:

- level to which the entity can support its forecast of economic conditions further into the future; and
- specific point at which it can no longer make a reasonable forecast.

### *Developing a reasonable and supportable forecast*

The following represents one way to develop a reasonable and supportable forecast.

| Steps | Comments |
|---|---|
| **Determine appropriate source(s) for an economic forecast** | Examples of sources include:<br>• publicly available external consensus forecasts;<br>• internal experts; and<br>• external experts. |
| **Determine the period that the source(s) provide(s) a sufficient basis on which an estimate can be made** | If using publicly available external consensus forecasts: the period that is reasonable and supportable may depend on the periods for which consensus forecasts are available.<br>If using an internal or external expert: the period that is reasonable and supportable may be a matter of the expert's professional judgment. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 7.3.20** May an entity assert that it cannot develop any economic forecasts and rely solely on historical losses?

**Interpretive response:** No. As a result of having different sources of information and/or different judgments about information, the length of the reasonable and supportable forecast period about future economic conditions may differ between entities. While some entities may be able to develop reasonable and supportable forecasts for longer periods than other entities, we do not believe it is acceptable for an entity to assert that it cannot develop any economic forecasts and rely solely on historical losses for an asset's entire contractual term.

## **Question 7.3.25** Is the reasonable and supportable forecast period determined based on an entity's ability to make or obtain forecasts of future economic conditions?

**Interpretive response:** Yes. We believe that the reasonable and supportable forecast period specifically relates to the entity's ability to forecast economic conditions. This is consistent with the Board's discussion in the basis for conclusions that reversion to historical credit losses is a relevant metric when "an entity is unable to precisely estimate future economic conditions for those periods." [ASU 2016-13.BC53, 326-20-30-9]

Once an entity has developed its reasonable and supportable forecast of economic conditions for purposes of estimating expected credit losses, it is required to adjust its historical loss information to reflect the extent to which management expects credit losses to differ during the reasonable and supportable forecast period as a result of forecasted conditions being different from the historical period. We do not believe it would be appropriate for an entity that has the ability to make or obtain reasonable and supportable forecasts of economic conditions to assert that it cannot reasonably estimate the effect of those conditions on expected credit losses.

For example, an entity makes or obtains a reasonable and supportable forecast of economic conditions for a five-year period. The entity should not assert that it cannot reasonably estimate the effect of that forecast on expected credit losses for all or a portion of that five-year period – i.e. it would not be appropriate to apply reversion for all or a portion of the five-year period. This is because applying a reversion approach for the remaining period would inherently reflect economic conditions different from the entity's reasonable and supportable forecast – which would be inconsistent with the notion of a best estimate of credit losses.

Subtopic 326-20 does not provide specific guidance for determining the extent of adjustments to make to historical loss information. Selecting the appropriate method to determine those adjustments requires management to exercise significant judgment. [326-20-30-9]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 7.3.30** May the length of the reasonable and supportable forecast period differ for different economic assumptions?

**Interpretive response:** Yes. The length of the reasonable and supportable forecast period may differ when different economic assumptions are relevant for different types of financial assets. For example, unemployment rates may be a key assumption for some assets, while a home price index may be a key assumption for other assets. An entity could conclude that those inputs have different reasonable and supportable forecast periods.

Similarly, when an entity incorporates an economic forecast into its estimate of expected credit losses, we believe it should consider whether that forecast is relevant to an asset or portfolio of assets for which an estimate is being prepared. For example, if an entity is using publicly available external consensus forecasts of economic conditions for the entire United States, it should consider whether that forecast is relevant to a portfolio of loans made to borrowers in a specific region. The entity may need to adjust the forecast based on the economic outlook for that region, or obtain forecasts that are more relevant to the specific region. In addition, forecasts for similar economic assumptions may not be available for all relevant geographies for the same period(s). As a result, the length of the reasonable and supportable forecast period may differ between geographies.

However, we believe an entity is expected to consider whether the assumptions are consistent with one another, especially when different sources are used for different assumptions.

## **Question 7.3.40** Is a statistical confidence level required to support the length of the reasonable and supportable forecast period?

**Interpretive response:** No. Subtopic 326-20 does not require an entity to develop a statistical confidence level to support the length of its reasonable and supportable forecast period.

However, if the length of the reasonable and supportable forecast period is shorter than the period for which relevant economic data is available, we believe an entity should provide support for its assertion that the longer-term forecast is not reasonable. One acceptable method is to use a measure of historical accuracy of previous forecasts.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 7.3.50** Is 'backtesting' the historical accuracy of the forecasting process required to substantiate whether a current period forecast is reasonable and supportable?

**Interpretive response:** No. We believe Subtopic 326-20 does not require an entity to backtest the historical accuracy of its forecasting process to substantiate whether its current forecast is reasonable and supportable. However, an entity may elect to use backtesting as a historical measure of its ability to forecast information when assessing the length of the reasonable and supportable period.

## **Question 7.3.60** Must an entity reevaluate the reasonable and supportable forecast period?

**Interpretive response:** Yes. We believe an entity is required to reevaluate the length of a reasonable and supportable forecast period at each reporting date because the length could change. For example, different or additional sources of supporting information may be considered or the period covered by the supporting information may have changed. Processes and related controls should be developed to support this ongoing evaluation.

## **Question 7.3.70** Should there be consistency between economic forecasts used for estimating expected credit losses and other purposes?

**Interpretive response:** It depends. An entity may use economic forecasts for a variety of purposes – e.g. budgeting, forecasting or capital planning; or valuation and/or impairment testing of loan servicing rights, deferred tax assets or goodwill.

We generally expect that an entity will consider the relevant economic forecasts used for other purposes (e.g. other accounting estimates) when evaluating whether the forecast for estimating the allowance for credit losses is reasonable and supportable. However, there may be instances where forecasts are not consistent. For example, a treasury function may use forecasts in its capital planning that are based on negatively biased or stressed scenarios. When forecasts are not consistent, an entity should consider documenting the reason(s) for the inconsistency.

While the economic forecasts used for estimating the allowance for credit losses generally are expected to be consistent with other economic forecasts used within the entity, the forecasted periods may differ. For example, an entity may forecast economic conditions for a defined period for use in regulatory stress testing, but conclude that for estimating expected credit losses it can make or obtain reasonable and supportable forecasts of economic conditions for a longer period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 7.3.10** Adjusting for differences in asset-specific risk characteristics and economic conditions

Bank is developing its estimate of expected credit losses for a portfolio of five-year commercial loans that share similar risk characteristics for the period ending December 31 of Year 0. All of the loans were newly originated at the end of Year 0.

To determine the appropriate historical loss information, Bank has selected the period that most closely reflects its future expectations, considering both the risk characteristics of the loans and the economic conditions. On that basis, it identifies lifetime loss experience for a portfolio of five-year commercial loans originated in Year -8 that matured in Year -3.

### *Assumptions*

The loans originated in Year -8 had annual loss rates of 0.10% and lifetime loss rates of 0.50%.

The economic conditions from Year -8 to Year -3 were worse than current conditions and Bank's forecasts of future conditions. Bank estimates that the differences in economic conditions will, in isolation, cause loan losses to decrease by 0.06% per annum.

The loans originated in Year -8 were similar to the loans for which Bank is estimating expected credit losses, with the exception of specific differences in underwriting. Bank estimates that the differences in underwriting will, in isolation, cause loan losses to increase by 0.05% per annum. This estimate assumes economic conditions consistent with Year -8 through Year -3.

Bank determines that its forecasts are reasonable and supportable only through Year +2. Bank has determined that it is appropriate to revert to historical loss experience on a straight-line basis following the reasonable and supportable forecast period.

### *Calculation*

As noted in Question 7.3.10, during the reasonable and supportable forecast period, adjustments to historical loss experience are made for differences in asset-specific risk characteristics (0.05% for differences in underwriting) and current and future economic conditions (-0.06%). After the reasonable and supportable forecast period, adjustments are made only for differences in asset-specific risk characteristics assuming economic conditions consistent with the historical period (0.05%).

The effects of reversion after Year +2 are ignored for illustration purposes (see section 7.3.30).

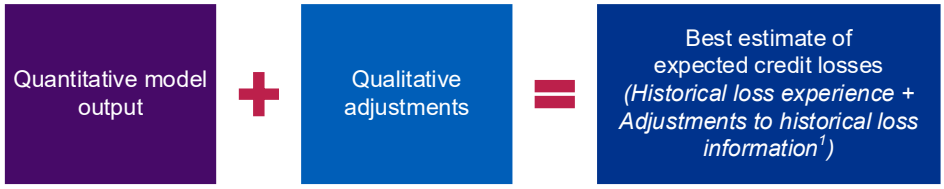
| Year | Unadjusted historical loss rates | Adjustment for differences in: | | Annual loss rate |
|---|---|---|---|---|
| | | Asset-specific risk charact. (i.e. underwrite.) | Economic conditions | |
| +1 | 0.10% | 0.05% | –0.06% | 0.09% |
| +2 | 0.10% | 0.05% | –0.06% | 0.09% |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Unadjusted historical loss rates | Adjustment for differences in: | | Annual loss rate |
|---|---|---|---|---|
| | | Asset-specific risk charact. (i.e. underwrite.) | Economic conditions | |
| +3 | 0.10% | 0.05% | | 0.15% |
| +4 | 0.10% | 0.05% | | 0.15% |
| +5 | 0.10% | 0.05% | | 0.15% |
| Cumulative lifetime loss rate | | | | 0.63% |

## **Question 7.3.75** Does an entity include 'qualitative' adjustment(s) in its estimate of expected credit losses?

**Interpretive response:** It depends. If the output of an entity's quantitative model does not reflect the entity's best estimate of expected credit losses in accordance with Subtopic 326-20, the entity should include qualitative adjustment(s).




Note:

1. Adjustments to historical loss information are made for:
   - differences in asset-specific risk characteristics (see section 7.3.10)
   - current economic conditions (see section 7.3.10)
   - reasonable and supportable forecasts of economic conditions (see section 7.3.20)
   - effects of reversion after the reasonable and supportable forecast period (see section 7.3.30)

Subtopic 326-20 does not provide specific guidance on the method that must be used to estimate credit losses or the extent of adjustments to historical loss information necessary to reflect differences in forecasted economic conditions or asset-specific risk characteristics. Therefore, selecting the appropriate methods requires management to exercise significant judgment. We believe an entity should adjust the output of its quantitative model to the extent needed for its allowance for credit losses to reflect its best estimate of expected credit losses in accordance with Subtopic 326-20. [326-20-30-9, 55-4, 55-6 – 55-7]

The following are examples.

- An entity that considers multiple economic scenarios for the reasonable and supportable forecast period may either:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

  - incorporate all scenarios into its quantitative model; or
  - incorporate only a single scenario into that model and separately use a qualitative adjustment to adjust the model's output to reflect the effect of scenarios not included in the model for the reasonable and supportable forecast period (see Question 7.3.16).

- An entity may use a quantitative model that estimates expected credit losses considering forecasted economic conditions during the reasonable and supportable forecast period, the estimated contractual term of its financial assets, and the volume and severity of past due and adversely classified financial assets. The entity may separately adjust the model's output to reflect the effects of other factors not captured in the model – e.g. changes in the quality of its credit review system or of the experience, ability and depth of management, lending staff and other relevant staff.

When an entity makes a qualitative adjustment to its quantitative model's output, it should be careful to avoid capturing in that adjustment the effects of factors already contemplated in the quantitative model – i.e. to avoid double counting. For example, an entity making a qualitative adjustment to reflect differences in asset-specific risk characteristics should avoid inadvertently also including the effects of economic conditions that are captured in the quantitative model in that adjustment.

Further, an entity should be careful to avoid capturing the effects of factors for which recognizing estimated credit losses are not permitted by Subtopic 326-20 – e.g. expected credit losses related to unfunded loan commitments that are unconditionally cancellable (see Example 13.3.05) or the effects of economic conditions beyond the reasonable and supportable forecast period.

## **Example 7.3.15** Qualitative adjustment to reflect changes in underwriting standards

Bank is estimating expected credit losses for a portfolio of similar loans. The underwriting standards when the portfolio was originated were more stringent than those used during the historical period from which historical loss information is being used to estimate losses.

Bank's quantitative model includes adjustments for forecasted economic conditions during the reasonable and supportable forecast period, but does not include adjustments for changes in underwriting standards. Therefore, Bank uses a qualitative adjustment to reflect the decreased expected credit losses associated with the improved underwriting standards.

To determine the extent of the qualitative adjustment, Bank uses a statistical analysis that estimates the effect changes in underwriting standards have had on credit losses based on Bank's historical experience.

In performing its statistical analysis, Bank isolates the effect of changes in underwriting standards. That is, Bank adapts its historical loss information to exclude the effects of other conditions or factors – such as different economic conditions – that also affected credit losses during those periods.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 7.3.16** Qualitative adjustment to reflect changes in collateral value

Bank is estimating expected credit losses for a portfolio of similar residential mortgage loans. Management has identified changes in collateral values and unemployment rates as conditions that may cause expected credit losses to differ from those experienced in the historical period.

Bank's quantitative model includes adjustments to credit losses for unemployment during the reasonable and supportable forecast period. Bank uses a qualitative adjustment to reflect differences in credit losses compared to historical experience as a result of estimated changes in collateral values.

When determining the extent of the qualitative adjustment for changes in collateral value, Bank uses a statistical analysis that estimates the effect changes in collateral value have had on credit losses based on Bank's historical experience. In performing its statistical analysis, Bank isolates the effect of changes in collateral value on credit losses that are unrelated to changes in unemployment. That is, Bank adapts its historical loss information to exclude the effects of unemployment on credit losses during those periods.

By adapting its historical loss information in this way, Bank avoids capturing the effect changes in unemployment are expected to have on credit losses during the reasonable and supportable period. This is captured in Bank's quantitative model and should not be double counted in a qualitative adjustment.

## **Question 7.3.77** Can a reversion-like approach be used to develop a forecast of future economic conditions during the reasonable and supportable forecast period?

**Background:** If an entity is not able to make or obtain reasonable and supportable forecasts of future economic conditions for the entire life of a financial asset, it is required to estimate expected credit losses for the remaining life using an approach that reverts to historical credit loss information. [326-20-30-9]

Some forecasts of future economic conditions, especially those that project over a longer term, are developed using a reversion-like approach. For example, an economist might project that unemployment rates will gradually return to projected long-term average unemployment rates over a given timeframe.

Using a reversion approach *beyond* the reasonable and supportable forecast period is specifically permitted in Subtopic 326-20. In contrast, Subtopic 326-20 does not specifically address using a reversion-like approach *during* the reasonable and supportable forecast period.

**Interpretive response:** Yes. We believe a reversion-like approach can be used to develop a forecast of future economic conditions during the reasonable and supportable forecast period – i.e. to *develop* the reasonable and supportable forecast as long as it represents an entity's best estimate of future economic conditions.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

We believe there are similarities and differences between a reversion approach applied after the reasonable and supportable forecast period and a reversion-like approach used to develop a reasonable and supportable forecast.

Some judgments that will need to be applied in both instances include:

- the period over which economic conditions will revert;
- what conditions will be reverted to; and
- whether the reversion will occur evenly over time, or in another pattern.

However, during the reasonable and supportable forecast period, an entity is not required to apply a reversion-like approach to develop its forecast. If it uses a reversion-like approach within the development of its forecast, it is not required to revert to historical loss experience or use a specific method of reversion – i.e. straight-line basis, immediate or another rational and systematic basis) to develop its forecast. Instead, an entity could revert to a projection, as opposed to reverting to historical loss experience. It could also revert using a method that is not systematic and rational. This additional flexibility requires a higher level of judgment and additional support to demonstrate why the assumptions used are consistent with the entity's best estimate of future economic conditions. For those reasons, we expect these judgments will generally be made by personnel with the requisite knowledge, skills and experience to develop economic forecasts.

Beyond the reasonable and supportable forecast period, an entity is required to revert to historical loss information immediately, on a straight-line basis, or using another rational and systematic basis. An entity should use the reversion method that, in combination with other assumptions and adjustments, results in its best estimate of expected credit losses. [326-20-30-9]

## 7.3.30 Reversion to historical loss information

As explained in section 7.3.20, as the length of a financial asset's contractual term increases, there will be circumstances in which relevant, detailed inputs will not be available to support forecasts over the entire remaining contractual term. Rather than reducing the allowance for credit losses to zero for those future periods, the FASB decided that an entity should base its estimate for the remaining period on a reversion to historical losses. [ASU 2016-13.BC52–BC53]

The guidance on reverting to historical credit losses should not be applied to periods that can be reasonably forecasted. In other words, while significant judgment may be necessary to determine whether a reasonable and supportable forecast can be made beyond a certain point, the guidance on reverting to historical losses should not be viewed as an election. Instead, it is a requirement that is applied only after the entity has made the determination that these forecasts cannot be made or obtained.

### *Reverting at input-level vs estimate-level*

Subtopic 326-20 permits an entity to revert to historical loss information at either the input level or based on the entire estimate. As discussed in Question 7.3.40, different economic assumptions may have reasonable and supportable forecast periods of differing lengths.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

If an entity chooses to revert at the input level, it identifies each significant input made in preparing the estimate and determines the period that the input can be forecasted in a reasonable and supportable manner. An entity then reverts to historical loss information that is specific to any input that cannot be forecasted for the asset's entire remaining contractual term. [326-20-30-9]

## **Example 7.3.20** Reversion at input level

ABC Corp. determines that each significant input into its expected credit loss estimate can be reasonably and supportably forecasted for the entire life of the financial asset with one exception: unemployment rates can be forecasted for only four years.

ABC chooses to apply reversion at the input level, so it estimates the asset's expected credit losses using:

- unemployment rates forecasted for four years, and then reverts to historical loss information for the remainder of the lifetime of the financial asset; and
- other inputs estimated for the entire lifetime of the financial asset.

## **Question 7.3.80** How is the reasonable and supportable forecast period determined when reversion is based on the entire estimate?

**Interpretive response:** If an entity reverts based on the entire estimate, rather than at the input level, we believe that the reasonable and supportable forecast period generally is limited to the shortest period of the significant economic inputs that can be forecasted.

## **Example 7.3.30** Reversion based on the entire estimate

This example is based on the facts in Example 7.3.20, except that ABC Corp. chooses to revert based on the entire estimate.

As a result, ABC estimates the asset's expected credit losses using adjustments for unemployment and other inputs forecasted for four years, which is the shortest period for which any of the significant economic inputs could be forecasted. It then reverts to historical loss information for the remainder of the lifetime of the financial asset.

### *Methods for reverting*

Subtopic 326-20 does not prescribe how an entity should revert to historical loss information. Instead, the FASB indicated that an entity could revert immediately, on a straight-line basis, or using another rational and systematic basis. [326-20-30-9]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

As further explained in Question 7.3.90, the reversion method selected by an entity is an assumption in its overall estimate of expected credit losses. As a result, when an entity is unable to develop reasonable and supportable forecasts for the full contractual term of its financial assets, it should apply a reversion method that, in combination with other assumptions and adjustments, results in an allowance that represents management's best estimate of expected credit losses.

We believe that it may be appropriate for an entity to apply different reversion methods for different asset types, portfolio segments, etc. Regardless of the method applied, an entity estimates the specific point at which a reasonable and supportable forecast can no longer be made. It is required to provide a discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period in its financial statement disclosures (see chapter 24).

## **Question 7.3.90** Is the reversion method a practical expedient?

**Interpretive response:** No. The FASB did not create a separate practical expedient. Further, selection of the method is not an accounting policy election. As a result, an entity should use the reversion method that results in its best estimate of expected credit losses and should reevaluate the method each reporting period.

We believe that once an entity can no longer make or obtain a reasonable and supportable forecast of economic conditions, Subtopic 326-20 requires it to prepare a best estimate of expected credit losses that does not include an adjustment to historical loss experience for these forecasts. However, the assumptions made in applying the reversion method should (in combination) be consistent with an entity's best estimate of expected credit losses. These assumptions include:

- the period used to determine the historical credit loss experience that an entity will revert to; and
- the method used to revert to the historical credit loss experience.

We believe the forecasted economic conditions immediately preceding the period covered by the reversion method will be a significant consideration in making these assumptions. For example, assume the forecasted economic conditions in this preceding period are expected to be significantly better or worse than average. An entity should consider that fact when determining both the period it uses to determine the historical credit loss experience (which is the experience to which it will revert) and the method it uses to revert.

If the selected historical loss period is a long-term average that includes a range of economic conditions, it may not be appropriate to revert immediately to those losses if the forecasted economic conditions at the end of the reasonable and supportable forecast period are different from the long-term average. However, in making this determination the entity would need to use judgment and consider its specific facts and circumstances, including the sensitivity of its expected credit losses to changes in economic conditions.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The SEC staff provides guidance for public companies in SEC Staff Accounting Bulletin No. 119 (which updated portions of SEC Staff Accounting Bulletin No. 102 to align with Topic 326). This guidance also was issued by federal banking agencies through the Federal Financial Institutions Examination Council's, *Policy Statement on Allowance for Loan and Lease Losses Methodologies and Documentation for Banks and Savings Institutions*. The guidance states, "A systematic methodology that is properly designed and implemented should result in a registrant's best estimate of its allowance for loan losses." [310-10-S99-4, Policy Statement]

We believe this guidance applies to the entire estimate of the allowance for credit losses, including the assumptions discussed above that are made in applying the reversion method.

## **Question 7.3.100** May an entity revert to historical loss experience over a period shorter than the remaining contractual term of the financial assets?

**Interpretive response:** Yes. We believe an entity can revert to historical loss experience over a period shorter than the remaining contractual term of the financial assets.

As discussed in Question 7.3.90, the estimate of the allowance for credit losses, including the selection of assumptions related to reversion, should be representative of an entity's best estimate of credit losses. We believe that in addition to selecting the reversion method, an entity should also choose the time period that results in its best estimate of expected credit losses. That time period, which could be shorter than the remaining contractual term of financial assets, should be reevaluated each reporting period.

For example, if a pool of financial assets has a contractual term of 10 years, and the entity is able to make or obtain a reasonable and supportable forecast for 3 years, it must choose a period over which it will revert from its reasonable and supportable forecast at the end of Year 3 to its historical loss experience. In some cases, it may be appropriate to revert over the entire remaining term, while in other cases a shorter reversion period may be appropriate. In making this judgment, an entity may consider the forecasted direction of economic conditions and historical patterns that economic conditions have taken in the past.

## **Example 7.3.40** Applying immediate and straight-line reversion

ABC Corp. is developing its estimate of expected credit losses for a portfolio of four-year, non-prepayable loans that were originated in the current year.

This Example illustrates applying certain reversion methods and is not intended to imply that other methods are not appropriate. As discussed in Question 7.3.90, the reversion method that is appropriate in a given period is that which

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

results in an entity's best estimate of expected credit losses. This determination is reevaluated each reporting period.

### *Assumptions*

The historical information shows that the annual loss rates that make up the cumulative lifetime loss rate are broken down as follows.

| Year | Loss rate |
|---|---|
| 1 | 3.0% |
| 2 | 2.0% |
| 3 | 1.0% |
| 4 | 1.0% |
| Cumulative lifetime loss rate | 7.0% |

ABC has determined that no adjustments are needed for asset-specific risk characteristics. ABC has also determined that it can develop a reasonable and supportable forecast for economic conditions for one year. To this end, ABC believes unemployment is the primary condition that may cause expected credit losses to differ from those in the historical period; the unemployment rate in the historical period was 4% and is expected to be 5% in one year. Based on this expectation, ABC determines that an adjustment of 0.8% for economic conditions is appropriate during the reasonable and supportable forecast period.

### *Scenario 1: Immediate reversion method*

If ABC applies the immediate reversion method, the cumulative loss rate is 7.8%.

| Year | Unadjusted historical loss rates | Adjustment for differences in | | Annual loss rate |
|---|---|---|---|---|
| | | Asset-specific risk charact. (i.e. underwrite.) | Economic conditions | |
| 1 | 3.0% | 0% | 0.8% | 3.8% |
| 2 | 2.0% | 0% | | 2.0% |
| 3 | 1.0% | 0% | | 1.0% |
| 4 | 1.0% | 0% | | 1.0% |
| Expected cumulative lifetime loss rate | | | | 7.8% |

### *Scenario 2: Straight-line reversion method (adjustment is reverted)*

If ABC applies the straight-line reversion method, the 0.8% economic adjustment may be amortized over the remaining period and result in a cumulative loss rate of 9.0%.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Unadjusted historical loss rates | Adjustment for differences in | | | Annual loss rate |
|---|---|---|---|---|---|
| | | Asset-specific risk charact. (i.e. underwrite.) | Economic conditions | Straight-line reversion | |
| 1 | 3.0% | 0% | 0.8% | | 3.8% |
| 2 | 2.0% | 0% | | 0.6% | 2.6% |
| 3 | 1.0% | 0% | | 0.4% | 1.4% |
| 4 | 1.0% | 0% | | 0.2% | 1.2% |
| Expected cumulative lifetime loss rate | | | | | 9.0% |

***Scenario 3: Straight-line reversion method (input is reverted)***

Rather than amortizing the *adjustment* to its historical loss rates (as in Scenario 2), ABC applies the straight-line reversion method in a manner that reverts the *forecasted economic conditions* on a straight-line basis. This means that the 1% difference between the 5% unemployment rate at the end of the reasonable and supportable forecast period and the 4% unemployment rate in the historical period is reduced on a straight-line basis.

| Year | Unadjusted historical unemployment rate | Adjustment for differences in unemployment rate | | Adjusted unemployment rate |
|---|---|---|---|---|
| | | During reasonable and supportable forecast period | Straight-line reversion | |
| 1 | 4.0% | 1.0% | | 5.00% |
| 2 | 4.0% | | 0.75% | 4.75% |
| 3 | 4.0% | | 0.50% | 4.50% |
| 4 | 4.0% | | 0.25% | 4.25% |

Under this approach, ABC determines the extent of the adjustment to historical loss rates that is needed in each year of the reversion period based on the adjusted unemployment rate presumed for that period – e.g. ABC determines the adjustment to historical information needed for Year 2 as if unemployment were forecasted to be 4.75% in that year. Because changes in economic conditions may not have a linear effect on expected credit losses, this approach may result in adjustments in Years 2–4 different from when the adjustment itself is reverted on a straight-line basis (i.e. the adjustments in Years 2–4 may be different than those determined in Scenario 2).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Unadjusted historical loss rates | Adjustment for differences in | | | Annual loss rate[1] |
|---|---|---|---|---|---|
| | | Asset-specific risk charact. (i.e. underwrite.) | Adjusted unemployment rate (including straight-line reversion) | Assumed adjustment | |
| 1 | 3.0% | 0% | 5.00% | 0.8% | 3.8% |
| 2 | 2.0% | 0% | 4.75% | 0.7% | 2.7% |
| 3 | 1.0% | 0% | 4.50% | 0.5% | 1.5% |
| 4 | 1.0% | 0% | 4.25% | 0.2% | 1.2% |
| Expected cumulative lifetime loss rate | | | | | 9.2% |

Note:
1. Unadjusted historical loss rate + Asset-specific risk characteristics + Adjustment.

## **Question 7.3.110** Can a reversion method effectively incorporate economic forecasts?

**Interpretive response:** No. A reversion method cannot incorporate economic forecasts beyond the reasonable and supportable forecast period. This is because incorporating economic forecasts into an entity's reversion method would have the practical effect of adjusting historical loss experience for those forecasts. Subtopic 326-20 precludes such adjustments beyond the reasonable and supportable forecast period. [326-20-30-9]

For example, assume Bank has determined its reasonable and supportable forecast period to be two years. There are economic forecasts available for three additional years, but Bank does not consider these forecasts to be 'reasonable and supportable'. The historical period Bank uses for its historical loss information reflects long-term average economic conditions. Bank should not use a reversion method that incorporates any economic forecast, such as using a reversion method that:

- assigns weights to forecasted economic conditions for periods beyond the reasonable and supportable forecast period and long-term average economic conditions; and
- gradually increases the weighting applied to the long-term average economic conditions until the forecast is entirely based on the long-term average economic conditions.

Such an approach would have the practical effect of adjusting the historical loss experience for the economic forecast beyond the reasonable and supportable forecast period.

Instead, an entity reverts to historical loss information immediately, on a straight-line basis, or using a rational and systematic basis for reverting. A reversion method that has a rational and systematic basis is a method for rationally and systematically removing (over time) the difference between the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

economic conditions that the entity forecasts will exist at the end of the reasonable and supportable period and the economic conditions underlying the historical loss information – e.g. using a supportable formula or mathematical curve. [326-20-30-9]

Although forecasts of economic conditions beyond the reasonable and supportable period should not be incorporated into an entity's reversion method, they may influence an entity's judgment when selecting *other* assumptions made in applying reversion – e.g. whether to revert immediately or over time and the length of the reversion period (see Questions 7.3.90 and 7.3.100).

Further, an entity can use a reversion-like approach to develop its forecast *within* the reasonable and supportable forecast period, as discussed in Question 7.3.77.

## 7.4 FASB examples

The examples in this section reproduced from Subtopic 326-20 illustrate how to apply historical loss experience with appropriate adjustments in the context of the following three methods for estimating expected credit losses:

- loss-rate approach (individual evaluation);
- vintage-year approach; and
- aging schedule approach.

### Excerpt from ASC 326-20

• > Example 2: Estimating Expected Credit Losses Using a Loss-Rate Approach (Individual Evaluation)

**55-23** This Example illustrates one way an entity may estimate expected credit losses on an individual loan using a loss-rate approach when no loans with similar risk characteristics exist.

**55-24** Community Bank B principally provides residential real estate loans to borrowers in the community. In the current year, Community Bank B expanded a program to originate commercial loans. Community Bank B has a few commercial loans outstanding at period end. In evaluating the loans, Community Bank B determines that one of the commercial loans does not share similar risk characteristics with other loans outstanding; therefore, Community Bank B believes that it is inappropriate to pool this commercial loan for purposes of determining its allowance for credit losses. This commercial loan has an amortized cost of $1 million. Historical loss information for commercial loans in the community with similar risk characteristics shows a 0.50 percent loss rate over the contractual term.

**55-25** Community Bank B considers relevant current conditions and reasonable and supportable forecasts that relate to its lending practices and environment and the specific borrower. Community Bank B determines that the significant factors affecting the performance of this loan are borrower-specific operating results and local unemployment rates. Community Bank B considers other

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

qualitative factors including national macroeconomic conditions but determines that they are not significant inputs to the loss estimates for this loan.

**55-26** Community Bank B is able to reasonably forecast local unemployment rates and borrower-specific financial results for one year only. Community Bank B's reasonable and supportable forecasts of those factors indicate that local unemployment rates are expected to remain stable (based on the main employer in the community continuing to operate normally) and that there will be a deterioration in the borrower's financial results (based on an evaluation of rent rolls). Management determines that no adjustment is necessary for local unemployment rates because they are expected to be consistent with the conditions in the 0.50 percent loss-rate estimate. However, the current and forecasted conditions related to borrower-specific financial results are different from the conditions in the 0.50 percent loss-rate estimate, based on borrower-specific information. Community Bank B determines that an upward adjustment of 10 basis points that is incremental to the historical lifetime loss information is appropriate based on those factors. Management estimates the 10-basis-point adjustment based on its knowledge of commercial loan loss history in the community when borrowers exhibit similar declines in financial performance. Management is unable to support its estimate of expectations for local unemployment and borrower-specific financial results beyond the reasonable and supportable forecast period. Under this loss-rate method, Community Bank B applies the same immediate reversion technique as in Example 1, where Community Bank B has immediately reverted into historical losses reflective of the contractual term in accordance with paragraphs 326-20-30-8 through 30-9.

**55-27** The historical loss rate to apply to the amortized cost basis of the individual loan would be adjusted an incremental 10 basis points to 0.60 percent. The allowance for expected credit losses for the reporting period would be $6,000.

## Excerpt from ASC 326-20

• > Example 3: Estimating Expected Credit Losses on a Vintage-Year Basis

**55-28** The following Example illustrates one way an entity might estimate the expected credit losses on a vintage-year basis.

**55-29** Bank C is a lending institution that provides financing to consumers purchasing new or used farm equipment throughout the local area. Bank C originates approximately the same amount of loans each year. The four-year amortizing loans it originates are secured by collateral that provides a relatively consistent range of loan-to-collateral-value ratios at origination. If a borrower becomes 90 days past due, Bank C repossesses the underlying farm equipment collateral for sale at auction.

**55-30** Bank C tracks those loans on the basis of the calendar year of origination. The following pattern of credit loss information has been developed (represented by the nonshaded cells in the accompanying table) based on the amount of amortized cost basis in each vintage that was written off as a result of credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year of Origination | Loss Experience in Years Following Origination | | | | | |
|---|---|---|---|---|---|---|
| | Year 1 | Year 2 | Year 3 | Year 4 | Total | Expected |
| 20X1 | $50 | $120 | $140 | $30 | $340 | – |
| 20X2 | $40 | $120 | $140 | $40 | $340 | – |
| 20X3 | $40 | $110 | $150 | $30 | $330 | – |
| 20X4 | $60 | $110 | $150 | $40 | $360 | – |
| 20X5 | $50 | $130 | $170 | $50 | $400 | – |
| 20X6 | $70 | $150 | $180 | **$60** | $460 | **$60** |
| 20X7 | $80 | $140 | **$190** | **$70** | $480 | **$260** |
| 20X8 | $70 | **$150** | **$200** | **$80** | $500 | **$430** |
| 20X9 | **$70** | **$160** | **$200** | **$80** | $510 | **$510** |

**55-31** In estimating expected credit losses on the remaining outstanding loans at December 31, 20X9, Bank C considers its historical loss information. It notes that the majority of losses historically emerge in Year 2 and Year 3 of the loans. It notes that historical loss experience has worsened since 20X3 and that loss experience for loans originated in 20X6 has already equaled the loss experience for loans originated in 20X5 despite the fact that the 20X6 loans will be outstanding for one additional year as compared with those originated in 20X5. In considering current conditions and reasonable and supportable forecasts, Bank C notes that there is an oversupply of used farm equipment in the resale market that is expected to continue, thereby putting downward pressure on the resulting collateral value of equipment. It also notes that severe weather in recent years has increased the cost of crop insurance and that this trend is expected to continue. On the basis of those factors, Bank C determines adjustments to historical loss information for current conditions and reasonable and supportable forecasts. The remaining expected losses (represented by the shaded cells in the table in paragraph 326-20-55-30 in each respective year) reflect those adjustments, and Bank C arrives at expected losses of $60, $260, $430, and $510 for loans originated in 20X6, 20X7, 20X8, and 20X9, respectively. Therefore, the allowance for credit losses for the reporting period date would be $1,260.

## Excerpt from ASC 326-20

• > Example 5: Estimating Expected Credit Losses for Trade Receivables Using an Aging Schedule

**55-37** This Example illustrates one way an entity may estimate expected credit losses for trade receivables using an aging schedule.

**55-38** Entity E manufactures and sells products to a broad range of customers, primarily retail stores. Customers typically are provided with payment terms of 90 days with a 2 percent discount if payments are received within 60 days. Entity E has tracked historical loss information for its trade receivables and compiled the following historical credit loss percentages:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

a. 0.3 percent for receivables that are current
b. 8 percent for receivables that are 1–30 days past due
c. 26 percent for receivables that are 31–60 days past due
d. 58 percent for receivables that are 61–90 days past due
e. 82 percent for receivables that are more than 90 days past due.

**55-39** Entity E believes that this historical loss information is a reasonable base on which to determine expected credit losses for trade receivables held at the reporting date because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit-loss percentages (that is, the similar risk characteristics of its customers and its lending practices have not changed significantly over time). However, Entity E has determined that the current and reasonable and supportable forecasted economic conditions have improved as compared with the economic conditions included in the historical information. Specifically, Entity E has observed that unemployment has decreased as of the current reporting date, and Entity E expects there will be an additional decrease in unemployment over the next year. To adjust the historical loss rates to reflect the effects of those differences in current conditions and forecasted changes, Entity E estimates the loss rate to decrease by approximately 10 percent in each age bucket. Entity E developed this estimate based on its knowledge of past experience for which there were similar improvements in the economy.

**55-40** At the reporting date, Entity E develops the following aging schedule to estimate expected credit losses.

| Past-Due Status | Amortized Cost Basis | Credit Loss Rate | Expected Credit Loss Estimate |
|---|---|---|---|
| Current | $5,984,698 | 0.27% | $16,159 |
| 1-30 days past due | 8,272 | 7.2% | 596 |
| 31-60 days past due | 2,882 | 23.4% | 674 |
| 61-90 days past due | 842 | 52.2% | 440 |
| More than 90 days past due | 1,100 | 73.8% | 812 |
| | **$5,997,794** | | **$18,681** |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 8. No allowance for credit losses

## Detailed contents

**8.1 How the standard works**

**8.2 Zero loss expectation exception**

8.2.10 Overview

**Questions**

**Question 8.2.10** What financial assets are eligible for the zero loss expectation exception?

**Question 8.2.20** What information does an entity consider when evaluating historical loss experience?

**Examples**

**Example 8.2.10** Investment grade security

**Example 8.2.20** Collateralized loan

**Example 8.2.30** Residential mortgage loan

**8.3 Agency-backed securities and sovereign debt**

8.3.10 Overview

8.3.20 Ginnie Mae guarantees

8.3.30 Financial assets that are fully guaranteed by Fannie Mae or Freddie Mac

8.3.40 Non-US sovereign debt

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 8.1 How the standard works

Subtopic 326-20 creates both:

- a general requirement that an allowance for credit losses be recognized for financial assets measured at amortized cost; and
- an exception for financial assets with a zero loss expectation.

If there is an expectation that a financial asset will have a zero loss, then an entity is not required to estimate or recognize an allowance for credit losses. This chapter explains how to determine if the 'zero loss expectation' exception applies to a financial asset.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 8.2 Zero loss expectation exception

## 8.2.10 Overview

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-10** An entity's estimate of expected credit losses shall include a measure of the expected risk of credit loss even if that risk is remote, regardless of the method applied to estimate credit losses. However, an entity is not required to measure expected credit losses on a financial asset (or group of financial assets) in which historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that nonpayment of the amortized cost basis is zero. Except for the circumstances described in paragraphs 326-20-35-4 through 35-6, an entity shall not expect nonpayment of the amortized cost basis to be zero solely on the basis of the current value of collateral securing the financial asset(s) but, instead, also shall consider the nature of the collateral, potential future changes in collateral values, and historical loss information for financial assets secured with similar collateral.

Subtopic 326-20 requires an entity's allowance for credit losses to reflect the risk of loss, even when that risk is remote. This is required whether the entity is estimating the allowance for a group of assets or an individual asset. Therefore, even if it is remote that an entity will incur a loss on a financial asset carried at amortized cost, it is required to estimate and recognize an allowance for credit losses. [326-20-30-10]

An exception to this requirement applies when a financial asset has a zero loss expectation. This zero loss expectation exception applies when historical credit loss experience adjusted for current conditions and reasonable and supportable forecasts provides an expectation that non-payment of the amortized cost basis is zero. If the exception applies, the entity is not required to estimate and recognize an allowance for credit losses. [326-20-30-10]

### *Financial assets secured by collateral*

An entity is not permitted to assume a zero loss expectation for a financial asset that is secured by collateral simply because the current value of the collateral exceeds the amortized cost basis of the asset. Rather, it is required to consider potential future changes in collateral value and historical loss experience for financial assets that were secured by similar collateral. However, there are special considerations when a collateral maintenance provision exists (see section 10.3) or the financial asset is collateral dependent (see section 10.2). [326-20-30-10]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 8.2.10** What financial assets are eligible for the zero loss expectation exception?

**Interpretive response:** The FASB decided not to identify specific financial assets that are eligible for the zero loss expectation exception. Determining whether the exception can be applied to a specific financial asset requires judgment. [ASU 2016-13.BC63]

To determine whether there is a zero loss expectation, we believe an entity needs to establish that it expects non-payment of an asset's amortized cost to be zero even if the borrower defaults. Therefore, the zero loss expectation exception can apply even if default could occur or has occurred as long as non-payment of the amortized cost basis is expected to be zero.

There are at least two types of financial assets for which an entity might determine that the zero loss expectation exception applies.

- **Securities issued or guaranteed by a government entity.** Certain of these securities might be eligible for the exception if the entity concludes that a loss would not be expected should the government entity default; see Example 8 from Subtopic 326-20 in section 8.3.
- **Financial assets secured by collateral provided by the borrower.** An entity might conclude that the exception can be applied to assets that are secured by collateral provided by the borrower, if the entity has concluded that a loss would not be expected on the occurrence of a default by the borrower. In that scenario, the entity's evaluation considers factors such as the potential future values of the collateral and the entity's historical loss experience when defaults have occurred in the past for similar assets.

Generally, an entity does not anticipate an expectation of zero losses for corporate bonds. Although an entity may have no history (or expectation) of loss for a particular corporate borrower, corporate bond default studies generally demonstrate that there is a risk of loss, even for highly rated bonds. Because Subtopic 326-20 requires an entity's allowance for credit losses to reflect the risk of loss – even when that risk is remote – we expect it generally will not be acceptable for an entity to establish a zero loss expectation for a highly rated (e.g. AAA) corporate bond it classifies as HTM.

## **Question 8.2.20** What information does an entity consider when evaluating historical loss experience?

**Interpretive response:** When an entity is evaluating historical loss experience and defaults have occurred in the past for similar assets, we believe it should consider all reasonably available information (both internal and external). The entity should not limit its consideration to loss experience in narrow, defined periods. We believe that a historical default in which the amortized cost basis was not fully repaid establishes a presumption that an allowance for credit losses of greater than zero is required.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 8.2.10** Investment grade security

ABC Corp. invests in a $1,000 HTM debt security issued by Borrower that has an investment-grade credit rating. ABC estimates that:

- the probability of Borrower defaulting on the security is 0.5%; and
- the loss expected if Borrower were to default is $400.

In this example, the zero loss expectation exception does not apply because the loss that is expected in the event of a default by Borrower ($400) is greater than zero. Therefore, ABC is required to estimate and recognize an allowance for credit losses for the security.

However, the allowance may be a relatively insignificant amount. For example, when considering the probability of default, ABC might conclude that the allowance for credit losses is $2 ($400 × 0.5%).

## **Example 8.2.20** Collateralized loan

ABC Corp. originates a $1,000 loan that is secured by collateral comprising $2,000 of highly liquid, relatively risk-free securities. ABC estimates that:

- the probability of Borrower defaulting on the loan is 2%; and
- the non-payment of the amortized cost basis that would be expected if Borrower were to default is zero. This is because of the nature of the collateral provided and the fact that its value exceeds, and is expected to continue to exceed, the loan's amortized cost basis.

In reaching its conclusion that non-payment of the amortized cost basis would be zero, ABC considers not only the adequacy of the current value of the collateral but also reasonable and supportable forecasts, including potential changes in fair value of the collateral in the future. In addition, ABC has experienced defaults on similarly collateralized loans in the past and, because of the collateral provided, has not experienced a credit loss related to those loans.

In this example, the zero loss expectation exception applies because if Borrower were to default, non-payment of the amortized cost basis is estimated to be zero. Therefore, ABC is not required to estimate or recognize an allowance for credit losses on the loan.

## **Example 8.2.30** Residential mortgage loan

ABC Corp. originates a $10 million portfolio of residential mortgage loans. Each of the loans in the portfolio is collateralized by a first lien on the borrower's primary residence. The estimated value of the collateral is such that the loan-to-value ratio is 80% for each of the mortgage loans.

ABC estimates the following:

- the likelihood of default for each mortgage loan is 1%; and
- non-payment of the amortized cost basis that would be expected if a borrower were to default is 15% of the amortized cost basis.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC estimates the loss given default of 15% based on historical loss experience when defaults have occurred for similar residential mortgage loans. This estimate reflects adjustments for current conditions and reasonable and supportable forecasts that consider potential future values for the collateral.

In this example, the zero loss expectation exception does not apply because if borrowers were to default, non-payment of the amortized cost basis is estimated to be greater than zero (15% of the amortized cost basis). Therefore, ABC recognizes an allowance for credit losses on the portfolio of residential mortgages.

## 8.3 Agency-backed securities and sovereign debt

### Excerpt from ASC 326-20

• > Example 8: Estimating Expected Credit Losses When Potential Default Is Greater Than Zero, but Expected Nonpayment Is Zero

**55-48** This Example illustrates one way, but not the only way, an entity may estimate expected credit losses when the expectation of nonpayment is zero. This example is not intended to be only applicable to U.S. Treasury securities.

**55-49** Entity J invests in U.S. Treasury securities with the intent to hold them to collect contractual cash flows to maturity. As a result, Entity J classifies its U.S. Treasury securities as held to maturity and measures the securities on an amortized cost basis.

**55-50** Although U.S. Treasury securities often receive the highest credit rating by rating agencies at the end of the reporting period, Entity J's management still believes that there is a possibility of default, even if that risk is remote. However, Entity J considers the guidance in paragraph 326-20-30-10 and concludes that the long history with no credit losses for U.S. Treasury securities (adjusted for current conditions and reasonable and supportable forecasts) indicates an expectation that nonpayment of the amortized cost basis is zero, even if the U.S. government were to technically default. Judgment is required to determine the nature, depth, and extent of the analysis required to evaluate the effect of current conditions and reasonable and supportable forecasts on the historical credit loss information, including qualitative factors. In this circumstance, Entity J notes that U.S. Treasury securities are explicitly fully guaranteed by a sovereign entity that can print its own currency and that the sovereign entity's currency is routinely held by central banks and other major financial institutions, is used in international commerce, and commonly is viewed as a reserve currency, all of which qualitatively indicate that historical credit loss information should be minimally affected by current conditions and reasonable and supportable forecasts. Therefore, Entity J does not record expected credit losses for its U.S. Treasury securities at the end of the reporting period. The qualitative factors considered by Entity J in this Example are not an all-inclusive list of conditions that must be met in order to apply the guidance in paragraph 326-20-30-10.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 8.3.10 Overview

Example 8 in Section 326-20-55 illustrates how an entity might develop a zero loss expectation for US Treasury securities classified as HTM. However, it indicates that the zero loss exception is not limited to these securities. We expect that many entities will reach a conclusion that securities carrying guarantees provided by Ginnie Mae (GNMA) (as an agency of the US government), and Fannie Mae and Freddie Mac (as government-sponsored enterprises, collectively, GSEs) should be evaluated in a manner similar to US Treasury securities. In evaluating whether a zero loss exception is appropriate for these securities, an entity should consider the nature and extent of the guarantee provided by the agency or GSE. We believe factors specific to these enterprises should be considered, as outlined in sections 8.3.20 and 8.3.30. [326-20-55-48 – 55-50]

## 8.3.20 Ginnie Mae guarantees

GNMA guarantees investors the full and timely payment of principal and interest on certain mortgage backed securities (MBS) backed by federally insured or guaranteed loans, mainly loans insured by the Federal Housing Administration (FHA) or guaranteed by the Department of Veterans Affairs (VA). MBS guaranteed by GNMA carry an explicit US government guarantee and typically have a term of 30 years.

The following qualitative factors are consistent with an expectation of zero credit losses.

- Full and timely payment of principal and interest on the MBS is explicitly guaranteed by GNMA as an agency of the US government.
- The ultimate guarantor (US government) can print its own currency.
- GNMA is essential in providing liquidity and stability to the US housing finance market. Therefore, it is unlikely that the US government would not perform on its guarantee obligation in the event that GNMA were to default on its guarantee – i.e. if default occurs, non-payment of the amortized cost basis is expected to be zero as a result of the US government guarantee.

However, there are certain other qualitative factors that could give rise to a possibility of credit losses on GNMA MBS. These factors should also be considered in the evaluation.

- Market participants do not price the GNMA MBS as risk-free.
- GNMA is a government agency and relies on funding from government appropriations.
- There may be heightened government budgetary concerns from time to time.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 8.3.30 Financial assets that are fully guaranteed by Fannie Mae or Freddie Mac

Fannie Mae and Freddie Mac (collectively, GSEs) provide liquidity to the secondary mortgage market by purchasing conventional conforming mortgage loans and issuing guaranteed MBS. The GSEs guarantee the timely payment of principal and interest to investors of certain MBS. Since September 2008, the GSEs have been under government conservatorship, operating under the direction of the Federal Housing Finance Agency (FHFA).

The following qualitative factors are consistent with an expectation of zero credit losses on GSE MBS.

- Principal and interest payments on the MBS are guaranteed by the GSEs.
- As part of entering into the 2008 conservatorship, the GSEs entered into a Purchase Agreement (through the FHFA) with the US government. Under the terms of the Purchase Agreement, the GSEs can draw funds (subject to a cap). Therefore, the MBS carry an 'explicit guarantee' from the US government up to this cap.
- The ultimate guarantor (US government) can print its own currency.
- The GSEs are essential in providing liquidity and stability to the US housing finance market. Therefore, it is unlikely that the US government would not perform in the event the GSEs were to default on their guarantees – i.e. if default occurs, non-payment of the amortized cost basis is expected to be zero due to the US government guarantee.

However, there are certain other qualitative factors that could give rise to a possibility of credit losses on GSE MBS. These factors should also be considered in the evaluation.

- Market participants do not price the MBS as risk-free.
- The explicit government guarantee is subject to a cap.
- There may be heightened government budgetary concerns from time to time.

## 8.3.40 Non-US sovereign debt

An entity needs to evaluate whether sovereign debt obligations from other jurisdictions have a zero loss expectation. Judgment is required when evaluating whether these debt obligations qualify for the zero loss expectation exception.

An entity may evaluate whether the sovereign debt obligation is similar to the US Treasuries described in Example 8 in Subtopic 326-20 by weighing several relevant factors. Specifically, an entity may consider whether the debt of a sovereign entity has the following.

- Debt:
  - a high credit rating by rating agencies;
  - a long history where non-payment of the amortized cost basis is zero;

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

  - explicit full guarantee by a sovereign entity;
  - interest rate is widely recognized as a 'risk-free rate'.

- Sovereign entity:

  - an ability to print its own currency;
  - low political uncertainty;
  - lack of significant budgetary concerns;
  - low credit default swap spreads;
  - currency is routinely held by central banks, used in international commerce, and commonly viewed as a reserve currency.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 9. Credit enhancements

## Detailed contents

**9.1 How the standard works**

**9.2 Determining whether a credit enhancement is freestanding**

9.2.10 Overview

**Questions**

**Question 9.2.10** When is a credit enhancement entered into separate and apart from other transactions?

**Question 9.2.20** When is a credit enhancement entered into in conjunction with a financial asset?

**Question 9.2.30** When is a credit enhancement legally detachable and separately exercisable?

**Examples**

**Example 9.2.10** Credit insurance

**Example 9.2.20** Insurance-wrapped debt security

**9.3 Accounting for freestanding purchased credit insurance contracts**

**Questions**

**Question 9.3.10** How does an insured entity account for a freestanding purchased credit insurance contract used to mitigate credit losses?

**Question 9.3.15** Does the guidance for freestanding purchased credit insurance contracts apply to a financial guarantee embedded in a hybrid financial instrument?

**Question 9.3.20** How does an insured entity determine whether a freestanding purchased credit insurance contract provides substantive risk transfer?

**Question 9.3.30** How is a freestanding purchased credit insurance contract outside the scope of Topic 815 accounted for if it does not provide substantive risk transfer?

**Examples**

**Example 9.3.10** Freestanding credit enhancement

**Example 9.3.20** Substantive risk transfer does not take place

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 9.1 How the standard works

In developing its estimate of expected credit losses under Topic 326, an entity considers how credit enhancements that are not freestanding contracts mitigate expected credit losses.

An entity recognizes and measures credit enhancements that are freestanding contracts (e.g. credit default swaps) separately from the underlying financial instrument that is subject to Topic 326.

Determining whether a credit enhancement contract is freestanding or is embedded in another financial instrument requires judgment and consideration of all facts and circumstances.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 9.2 Determining whether a credit enhancement is freestanding

## 9.2.10 Overview

### Excerpt from ASC 326-20

> Credit Enhancements

**30-12** The estimate of expected credit losses shall reflect how credit enhancements (other than those that are **freestanding contracts**) mitigate expected credit losses on **financial assets**, including consideration of the financial condition of the guarantor, the willingness of the guarantor to pay, and/or whether any subordinated interests are expected to be capable of absorbing credit losses on any underlying financial assets. However, when estimating expected credit losses, an entity shall not combine a financial asset with a separate freestanding contract that serves to mitigate credit loss. As a result, the estimate of expected credit losses on a financial asset (or group of financial assets) shall not be offset by a freestanding contract (for example, a purchased credit-default swap) that may mitigate expected credit losses on the financial asset (or group of financial assets).

**20 Glossary**

**Freestanding contract**

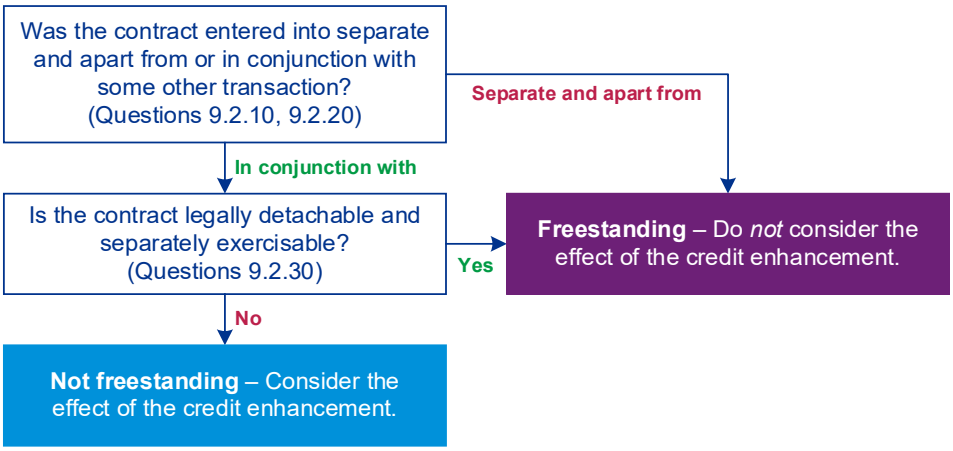
A freestanding contract is entered into either:

a. Separate and apart from any of the entity's other financial instruments or equity transactions
b. In conjunction with some other transaction and is legally detachable and separately exercisable.

Separate, freestanding contracts that serve to mitigate credit losses – e.g. purchased credit default swaps or certain types of insurance – should not be considered for the purposes of estimating expected credit losses. [326-20-30-12]

The following decision tree, which is based on the definition of a freestanding contract, provides one acceptable method for performing the analysis to determine whether the credit enhancement is freestanding. [326-20 Glossary]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.




## Question 9.2.10 When is a credit enhancement entered into separate and apart from other transactions?

**Interpretive response:** For a credit enhancement contract to be considered as entered into separate and apart from an entity's other financial instruments transactions, it needs to be contractually distinct.

In addition, we believe that when two or more contractually distinct instruments are entered into, the evaluation may differ based on whether the instruments were entered into with the same or different counterparties.

| Counterparties | Analysis |
|---|---|
| **Separate, unrelated counterparties** | Except in rare circumstances, we believe each instrument should be considered freestanding under this criterion, even if they are issued contemporaneously or within a very short time period. |
| **Same counterparty (or related party group)** | We believe two conditions should be met to conclude that one or more of the instruments has been entered into separate and apart from any of the entity's other financial instruments transactions:<br>• the instruments are contractually distinct – i.e. each instrument is documented separately; and<br>• there is a reasonable period between the issuance of the various financial instruments being evaluated. |

## Question 9.2.20 When is a credit enhancement entered into in conjunction with a financial asset?

**Interpretive response:** Except in rare circumstances, we believe for a credit enhancement to be considered as entered into in conjunction with a financial asset, it should be entered into as part of the same contract as the financial

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

asset and with the same counterparty. Said differently, it should not be contractually distinct.

A credit enhancement can either be entered into separate and apart from or in conjunction with other transactions. Therefore, if the credit enhancement is not entered into separate and apart from a transaction, it is likely entered into in conjunction with a transaction. See Question 9.2.10 for more information regarding the analysis of separate and apart.

## **Question 9.2.30** When is a credit enhancement legally detachable and separately exercisable?

**Interpretive response:** Legally detachable and separately exercisable generally means the credit enhancement and the financial asset can be separated such that the two components may be held by different parties.

In general, we believe it is not necessary for the financial instrument being evaluated to be transferable to third parties for it to be considered legally detachable and separately exercisable. However, if the underlying financial asset is transferable and the credit enhancement must be transferred with the underlying financial asset, that is generally an indication that the credit enhancement is not legally detachable and separately exercisable.

We believe one important factor to consider when evaluating whether a credit enhancement is legally detachable and separately exercisable is whether it is possible that the remaining financial instrument(s) would continue to exist unchanged when the other financial instrument is exercised.

For example, consider a credit enhancement that a lender obtains in the form of a co-signor for a consumer loan. If the primary borrower defaults on the loan, the lender can seek repayment from the co-signor. After the lender has recovered the loan balance from the co-signor, the lender no longer retains a claim against the primary borrower for the amounts paid by the co-signor. In this case, the credit enhancement is not freestanding.

## **Example 9.2.10** Credit insurance

Lenders may manage exposure to credit risk in their portfolios by acquiring supplemental insurance coverage. Typically the insurance company compensates the lender for losses in the event of default by the borrower. For example, in the case of mortgage insurance, the insurance company compensates the lender for losses sustained when the mortgage is foreclosed and the property is sold.

Two common examples of insurance coverage are analyzed in the following table. It is assumed that the insurance contracts are not treated as derivatives because the holder is compensated only if, as a result of an identifiable insurable event, the holder incurs a liability or there is an adverse change in the value of a specific asset or liability for which the holder is at risk. [815-10-15-52 – 15-54]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Description | Scenario 1 | Scenario 2 |
|---|---|---|
| **Nature of coverage** | Lender requires Borrower to take insurance coverage for specific loans – e.g. when the loan-to-value ratio exceeds a specified level (say 80%).<br>A separate contract is entered into between Insurer and Borrower, with Lender named as the beneficiary. The individual coverage is often referred to as private mortgage insurance (PMI). | Lender acquires mortgage insurance covering a portfolio of loans. The insurance policy provides coverage only for losses incurred by Lender, and therefore does not cover a subsequent purchaser if the loans are subsequently sold. |
| **Premiums** | Typically paid by Borrower. | Typically paid by Lender. |
| **Is the insurance contract (i.e. the credit enhancement) entered into separate and apart from, or in conjunction with the mortgage loan?** | The terms of the mortgage state that when Lender requires mortgage insurance as a condition of making the loan, Borrower is required to maintain the insurance unless written approval is obtained from Lender. The PMI is therefore incorporated into the mortgage agreement between Lender and Borrower and, as a result, the PMI is not contractually distinct. Instead, it was obtained in conjunction with the mortgage loan. | Lender enters into contractually distinct instruments with separate, unrelated counterparties – i.e. the loans with the Borrowers and the insurance contract with Insurer. Therefore, the insurance contract was entered into separate and apart from the loans and is considered a freestanding contract. |
| **Is the contract legally detachable and separately exercisable?** | No, the insurance contract is neither legally detachable from the loan nor separately exercisable. If the loan is sold, the insurance contract transfers with the loan and the new owner of the loan will be the beneficiary.<br>Additionally, if Borrower defaults and the PMI payment is triggered, Lender has no remaining claim against the loan to Borrower. | N/A<br>When an instrument is entered into separate and apart from other transactions, it is considered freestanding and this evaluation is not required. |
| **Is the insurance contract freestanding?** | No, the insurance contract is not freestanding. | Yes, the insurance contract is freestanding. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Description | Scenario 1 | Scenario 2 |
|---|---|---|
| **Consideration of credit enhancement (insurance) in estimating expected credit losses** | Should be considered in estimating expected credit losses because the credit enhancement is not a freestanding contract.<br>Insurer's financial condition, willingness and ability to pay claims should be considered in the estimate. | Should not be considered in estimating expected credit losses because the credit enhancement is a freestanding contract. |

## Example 9.2.20 Insurance-wrapped debt security

XYZ Corp. purchases an ABC City municipal bond and classifies the bond as HTM.

The municipal bond prospectus states that scheduled payments of principal and interest are guaranteed by Insurer under an insurance policy to be issued concurrently with the municipal bond. In the event that ABC does not make a principal or interest payment on its scheduled date, Insurer will make the payments to the bondholder (XYZ). ABC will pay the premium(s) on the insurance policy to Insurer.

If XYZ sells the municipal bond to another entity, the purchaser becomes the beneficiary of the insurance.

The financial guaranty insurance is a credit enhancement. The following chart illustrates how XYZ analyzes whether to consider this credit enhancement in estimating expected credit losses on the municipal bond.

| Description | Municipal bond with an insurance wrapper |
|---|---|
| **Is the financial guaranty insurance contract (i.e. the credit enhancement) entered into separate and apart from, or in conjunction with the municipal bond?** | The terms of the municipal bond contract (the prospectus) include the provision that the municipal bond is insured and that the bondholder is the beneficiary of the insurance. Therefore, the financial guaranty insurance is not contractually distinct and was obtained in conjunction with the municipal bond. |
| **Is the contract legally detachable or separately exercisable?** | No, the insurance contract is neither legally detachable from the municipal bond nor separately exercisable. If the municipal bond is sold, the insurance contract transfers with the municipal bond and the new owner of the bond will be the beneficiary. Additionally, if ABC defaults, Insurer will make the scheduled principal and interest payments to XYZ, and XYZ will no longer have a claim against ABC for those payments. |
| **Is the insurance contract freestanding?** | No, the insurance contract is not freestanding. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Description | Municipal bond with an insurance wrapper |
|---|---|
| **Consideration of credit enhancement (insurance) in estimating expected credit losses** | The insurance contract should be considered in estimating expected credit losses because the credit enhancement is not a freestanding contract.<br>Insurer's financial condition, willingness and ability to pay claims, should be considered in the estimate. |

## 9.3 Accounting for freestanding purchase credit insurance contracts

Many entities enter into freestanding credit enhancement contracts, such as freestanding purchased credit insurance contracts, to mitigate credit losses on financial assets in the scope of Topic 326.

### **Question 9.3.10** How does an insured entity account for a freestanding purchased credit insurance contract used to mitigate credit losses?

**Background:** Freestanding purchased credit insurance contracts can take several forms and contain a variety of terms. The terms in the contract influence the accounting method used.

US GAAP does not explicitly address how the insured entity (the holder) accounts for a freestanding purchased credit insurance contract that meets the following criteria:

- is legally enforceable;
- the insured entity is expected to make all contractually required premium payments;
- is expected to be in force when a loss event occurs (i.e. default);
- the insured event has not occurred for any of the financial assets covered by the policy;
- is not accounted for as a derivative under Topic 815; and
- provides for substantive risk transfer (see Question 9.3.20).

**Interpretive response:** In a March 2020 FASB meeting, the Board acknowledged that there are multiple views when accounting for a freestanding purchased credit insurance contract used to mitigate credit losses when the criteria above are met. Three of the approaches that we consider acceptable are the mirror image accounting method, the probable incurred loss and recovery method, and the insurance contract claim method. Other accounting policies may also be acceptable. We believe the chosen policy should be applied consistently.

These three approaches address how to account for the insurance receivable related to expected claims, the premiums paid (or to be paid in the future), and the credit losses and related provision.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### *Mirror image accounting method*

Under a mirror image approach, the insured entity measures the insurance receivable based on the amount of expected credit losses recognized under Topic 326. We have identified two separate methods for recording the insurance premiums.

#### Mirror image method 1

Under this method, the insured entity records an insurance receivable at contract inception and measures the receivable at the same amount as the expected credit losses that are recognized under Topic 326 with a corresponding amount recognized in earnings. In subsequent periods, the insurance receivable is adjusted to match the related portion of the expected credit losses that are recognized under Topic 326 with a corresponding amount recognized in earnings. The amounts recognized as an insurance receivable factor in any deductible – i.e. the insurance receivable is net of any deductible.

Under this method, the full amount of insurance premiums paid (or payable) is deferred at the contract's inception and amortized into expense over the insured period.

#### Mirror image method 2

Similar to method 1:

- an entity records an insurance receivable at contract inception and measures the receivable at the same amount as the related portion of the expected credit losses that are recognized under Topic 326, net of any deductible; and
- premium expense is recognized over the insured period.

However, in contrast to method 1, only the excess of insurance premiums paid (or payable) over the amount of the insurance receivable initially recognized is deferred and amortized into expense.

Similar to method 1, in subsequent periods the insurance receivable is adjusted to match the related portion of the expected credit losses that are recognized under Topic 326 with a corresponding amount recognized in earnings.

### *Probable incurred loss and recovery method*

Under this method, an insurance receivable, and the related earnings, are recognized only when:

- an incurred loss that is insured under the contract is probable of occurring; and
- the recovery of the insurance receivable is probable.

Under this method, the full amount of insurance premiums paid (or payable) are deferred at inception of the contract and amortized into expense over the insured period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

***Insurance contract claim method***

Under this method, an insurance receivable, and the related earnings, are recognized only when:

- a loss event occurs (i.e. a default);
- a claim is submitted or the insured party has the ability under the contractual terms of the contract to submit a claim; and
- the recovery of the insurance receivable is probable.

Under this method, the full amount of insurance premiums paid (or payable) are deferred at inception of the contract and amortized into expense over the insured period.

## **Example 9.3.10** Freestanding credit enhancement

Bank originates a $100,000,000 portfolio of loans and estimates the allowance for credit losses on the portfolio as $1,000,000 under Topic 326. Concurrently, Bank enters into a freestanding purchased credit insurance contract with Insurer.

Under the contract, Bank pays $2,100,000 of premiums to Insurer at inception. In exchange, Insurer insures 100% of Bank's credit losses on the portfolio of loans throughout the contractual term of the loans.

Bank concludes that Insurer's expected profit margin is consistent with a profit margin that would be demanded by an insurer assuming substantive insurance risk related to this portfolio. Bank also considers the other factors in Question 9.3.20, and concludes that the contract involves substantive risk transfer.

At origination of the loans and inception of the freestanding purchased credit insurance contract, an incurred loss on the loans and recovery of the insurance receivable is not considered probable and no claims are eligible to be submitted under the contract. Bank determines the contract is legally enforceable, is expected to be in force when a loan in the portfolio defaults and is not accounted for as a derivative under Topic 815. Bank is expected to make all contractually required premium payments.

The journal entries below illustrate:

- the origination of the loans;
- the application of four possible accounting policies for the freestanding purchased credit insurance contract at origination of the loans and inception of the contract; and
- the related entries to the allowance for credit losses.

***Mirror image method 1***

Bank makes the following journal entries at origination of the loans and inception of the freestanding purchased credit insurance contract.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Loans | 100,000,000 | |
| Cash | | 100,000,000 |
| *To record origination of loans.* | | |
| Credit loss expense | 1,000,000 | |
| Allowance for credit losses | | 1,000,000 |
| *To record estimate of expected credit losses on portfolio of loans at origination.* | | |
| Insurance receivable[1] | 1,000,000 | |
| Gain on recovery of insured credit losses | | 1,000,000 |
| *To record insurance receivable from freestanding purchased credit insurance contract.* | | |
| Credit loss expense[1] | 1,000 | |
| Allowance for credit losses | | 1,000 |
| *To record estimate of credit losses on insurance receivable at inception.* | | |
| Deferred premium expense[2] | 2,100,000 | |
| Cash | | 2,100,000 |
| *To record premiums paid for freestanding purchased credit insurance contract.* | | |

Notes:

1. Neither the insurance recovery asset nor the related amounts recorded in earnings are presented net against the allowance for credit losses or credit loss expense.
2. The premiums paid at inception are deferred and amortized over the insured period.

### *Mirror image method 2*

Bank makes the following journal entries at origination of the loans and inception of the freestanding purchased credit insurance contract.

| | Debit | Credit |
|---|---|---|
| Loans | 100,000,000 | |
| Cash | | 100,000,000 |
| *To record origination of loans.* | | |
| Credit loss expense | 1,000,000 | |
| Allowance for credit losses | | 1,000,000 |
| *To record estimate of expected credit losses on portfolio of loans at origination.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Insurance receivable[1] | 1,000,000 | |
| Deferred premium expense[2] | 1,100,000 | |
| Cash | | 2,100,000 |
| *To record insurance receivable and deferred premiums from freestanding purchased credit insurance contract.* | | |
| Credit loss expense[1] | 1,000 | |
| Allowance for credit losses | | 1,000 |
| *To record estimate of credit losses on insurance receivable at inception.* | | |

Notes:

1. Neither the insurance receivable nor the related amounts recorded in earnings are presented net against the allowance for credit losses or credit loss expense.
2. Deferred premium expense is calculated as the excess of insurance premiums paid ($2,100,000) over the amount of the insurance receivable ($1,000,000). The premiums deferred are amortized over the insured period.

### *Probable incurred loss and recovery method*

Bank makes the following journal entries at origination of the loans and inception of the freestanding purchased credit insurance contract.

| | Debit | Credit |
|---|---|---|
| Loans | 100,000,000 | |
| Cash | | 100,000,000 |
| *To record origination of loans.* | | |
| Credit loss expense | 1,000,000 | |
| Allowance for credit losses | | 1,000,000 |
| *To record estimate of expected credit losses on portfolio of loans.* | | |
| Deferred premium expense[1,2] | 2,100,000 | |
| Cash | | 2,100,000 |
| *To record deferred premiums from freestanding purchased credit insurance contract.* | | |

Notes:

1. At inception, an incurred loss is not probable, and therefore an insurance receivable is not recognized. The insurance receivable will be recognized when an incurred loss and recovery of the receivable are both probable.
2. The premiums paid at inception are deferred and amortized over the insured period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

***Insurance contract claim method***

Bank makes the following journal entries at origination of the loans and inception of the freestanding purchased credit insurance contract.

| | Debit | Credit |
|---|---|---|
| Loans | 100,000,000 | |
| Cash | | 100,000,000 |
| *To record origination of loans.* | | |
| Credit loss expense | 1,000,000 | |
| Allowance for credit losses | | 1,000,000 |
| *To record estimate of expected credit losses on portfolio of loans.* | | |
| Deferred premium expense[1,2] | 2,100,000 | |
| Cash | | 2,100,000 |
| *To record deferred premiums from freestanding purchased credit insurance contract.* | | |

Notes:

1. At inception, there are no claims that are eligible to be submitted under the contract. Therefore, the conditions for recognizing an insurance receivable have not been met. The insurance receivable will be recognized when there is an eligible claim under the terms of the insurance contract.
2. The premiums paid at inception are deferred and amortized over the life of the insurance contract.

## **Question 9.3.15** Does the guidance for freestanding purchased credit insurance contracts apply to a financial guarantee embedded in a hybrid financial instrument?

**Background:** A financial guarantee is a contract that contingently requires a guarantor to make payments due to a failure of another party to satisfy its required payment obligations. See chapter 14 for more information on guarantees.

**Interpretive response:** No. A financial guarantee contract embedded in a hybrid financial instrument is not a freestanding credit enhancement when it is not bifurcated from the host contract under Topic 815. Since the credit enhancement is not freestanding, the guidance for freestanding purchased credit insurance contracts in Question 9.3.10 does not apply.

The guidance for freestanding purchased contracts also does not apply when the financial guarantee contract embedded in a hybrid financial instrument is bifurcated from the host contract and accounted for as a derivative. Financial guarantees accounted for as derivatives do not meet the criteria to apply the guidance in Question 9.3.10. [815-15-25-1]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 9.3.20** How does an insured entity determine whether a freestanding purchased credit insurance contract provides substantive risk transfer?

**Interpretive response:** In determining whether a purchased freestanding credit insurance contract provides substantive risk transfer, we believe the following should be among the factors considered:

- whether the amount and timing of the insurer's payments to the insured entity depend on, and vary directly with, the amount and timing of claims settled under the contract;
- the probability and magnitude of potential variation in the amount and timing of claims payments made by the insurer; and
- whether, at inception of the contract, the excess of (1) the present value of expected amounts payable to the insurer over (2) the present value of expected amounts receivable from the insurer, are indicative of a financing-like return to the insurer – as opposed to a return that would be paid to an insurer that is assuming substantive insurance risk.

The assessment of whether a freestanding purchased credit insurance contract provides substantive risk transfer involves significant judgment. Entities should carefully consider all terms and features of the contract (including relevant side agreements), especially those that limit insurance risk of the insurer or delay the timely payment of claims to the insured entity.

## **Example 9.3.20** Substantive risk transfer does not take place

Bank originates a portfolio of non-prepayable loans with an original amortized cost basis of $100,000,000. At inception, Bank estimates the allowance for credit losses on the portfolio is $1,000,000.

On the same date, Bank enters into a freestanding purchased credit insurance contract with Insurer. Under the contract, Insurer will insure the first $250,000 of credit losses incurred by Bank in exchange for premiums with a net present value of $275,000.

At the time the contract is executed, the likelihood that Bank will incur less than $250,000 of credit losses over the contractual term of the insurance contract is remote. Further, the excess of the net present value of expected premiums ($275,000) over expected claims ($250,000) is consistent with a financing-like return over the contract period for Insurer and would not be consistent with the return typically demanded by an insurer that is assuming substantive insurance risk.

In this scenario, Bank considers the following.

- The loss cap of $250,000 limits the variability in the timing and amount of claims payments made by Insurer under the contract. There is also a remote probability of significant variation in the amount and timing of claims

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

payments because the $250,000 losses are considered highly likely over the contractual term.

- Insurer is protected from a loss under the contract because the net present value of premiums ($275,000) exceeds the maximum amount of insured losses ($250,000).
- The contract is expected to provide a financing-like return to Insurer, as opposed to a return consistent with the transfer of substantive insurance risk.

After considering the factors described above, Bank concludes that the contract does not provide substantive risk transfer.

## **Question 9.3.30** How is a freestanding purchased credit insurance contract outside the scope of Topic 815 accounted for if it does not provide substantive risk transfer?

**Interpretive response:** When a freestanding purchased credit insurance contract outside the scope of Topic 815 does not provide substantive risk transfer, we believe the entity should apply the deposit method described in Subtopic 340-30.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 10. Practical expedients and simplifications

## Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

**10.1 How the standard works**

**10.2 Collateral-dependent financial assets**

10.2.10 Overview

10.2.20 Scope

10.2.30 Measurement

**Questions**

**Question 10.2.10** [Not used]

**Question 10.2.20** [Not used]

**Question 10.2.30** [Not used]

**Question 10.2.40** [Not used]

**Question 10.2.45** If foreclosure is not probable, can the practical expedient be applied regardless of which party will operate the collateral?

**Question 10.2.50** How does an entity determine if the debtor is experiencing financial difficulty?

**Question 10.2.60** Once an entity has elected the practical expedient when foreclosure is not probable, must it reassess the expedient's applicability in subsequent periods?

**Question 10.2.65** What types of costs are considered in estimated selling costs?

**Question 10.2.70** Is the practical expedient applied at the individual financial asset level?

**Question 10.2.80** Are credit enhancements considered when estimating expected credit losses using the practical expedient?

**Question 10.2.85** How does an entity account for a subsequent increase in the fair value of the collateral?

**Question 10.2.90** When a loan is considered collateral-dependent, must an entity use the fair value of collateral to estimate expected credit losses for bank regulatory reporting purposes?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 10.2.95** Do expected credit losses include amounts anticipated to be collected from a borrower after foreclosure or repossession when the lender applies the collateral dependent practical expedient?

**Question 10.2.100** Can an entity use liquidation value to estimate expected credit losses for a collateral-dependent financial asset, if different from fair value?

**Examples**

**Example 10.2.05** Evaluating whether the debtor is experiencing financial difficulties

**Example 10.2.10** Application of the practical expedient when the debtor operates the property

**Example 10.2.20** Increase in fair value of collateral after a previous writeoff

**Example 10.2.30** Estimating the allowance before repossession

**Example 10.2.35** Estimating the allowance after repossession

## 10.3 Collateral maintenance provisions

**Questions**

**Question 10.3.10** To apply the practical expedient, does an entity need to assess whether the borrower will replenish the collateral?

**Question 10.3.15** What should an entity consider when evaluating whether a borrower is required to continually adjust the amount of collateral?

**Question 10.3.20** How does an entity apply the practical expedient when the fair value of the collateral is equal to or greater than the amortized cost basis?

**Question 10.3.30** How does an entity apply the practical expedient when the fair value of the collateral is less than the amortized cost basis?

**Example**

**Example 10.3.10** Repurchase agreement

## 10.4 Current accounts receivable and contract assets**

10.4.10 Overview

10.4.20 Practical expedient to assume current conditions do not change

10.4.30 Accounting policy to consider subsequent collection activity

10.4.40 Comprehensive examples

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Questions

**Question 10.4.10** What assets are in scope of the simplifications?

**Question 10.4.20** Do the simplifications apply to current accounts receivable and contract assets that are acquired?

**Question 10.4.30** Are the simplifications to be applied consistently to current contract receivables and contract assets?

**Question 10.4.40** What is the practical expedient to assume current conditions do not change?

**Question 10.4.50** What entities are in the scope of the practical expedient to assume current conditions do not change?

**Question 10.4.60** Does the practical expedient permit an entity to assume current conditions as of the balance sheet date are the same as in historical periods?

**Question 10.4.70** What is the accounting policy that permits an entity to consider subsequent collection activity?

**Question 10.4.80** What entities are in the scope of the accounting policy to consider subsequent collection activity?

**Question 10.4.90** How is the accounting policy to consider subsequent collection activity applied?

**Question 10.4.100** Can an entity consider subsequent collection activity in historical loss rates applied to remaining uncollected assets?

**Question 10.4.110** Is it a change in accounting principle to change the date through which subsequent collection activity is considered?

## Example

**Example 10.4.10** Effect of applying the simplifications

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

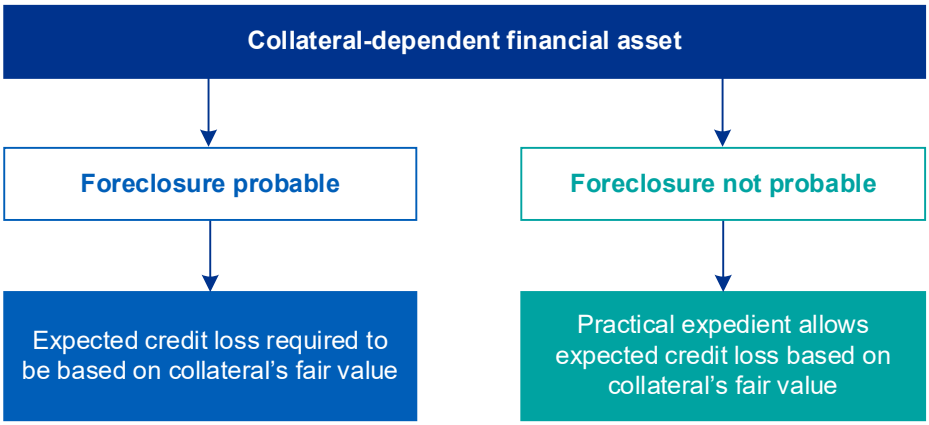
## 10.1 How the standard works

Subtopic 326-20 provides certain practical expedients and simplified guidance for estimating expected credit losses.

### *Collateral-dependent financial assets (section 10.2)*

The principles for estimating expected credit losses of collateral-dependent assets differ from the general measurement principles under the expected credit loss model.

A financial asset is collateral-dependent when the debtor is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. Subtopic 326-20 includes specific guidance on estimating expected credit losses for collateral-dependent financial assets.




For guidance on how to estimate expected credit losses when the practical expedient for collateral-dependent financial assets is not applied, see chapters 4 to 8.

### *Collateral maintenance provisions (section 10.3)*

Certain arrangements require the borrower to continually adjust the amount of collateral securing the financial asset as a result of changes in the fair value of the collateral. These arrangements are 'collateral maintenance provisions'.

For these types of arrangements, when the borrower is expected to replenish the collateral as required by the terms of the agreement, Subtopic 326-20 permits (but does not require) the use of a practical expedient. Under this practical expedient, an entity estimates expected credit losses for any difference between the financial asset's amortized cost basis and the fair value of the collateral securing the financial asset. This means that if the amortized cost basis is greater, the entity estimates expected credit losses for the portion of the amortized cost that is greater than the fair value of the collateral.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## *Current accounts receivable and contract assets (section 10.4)***

Subtopic 326-20 provides two simplifications that can be used when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers).

| Simplification | Summary |
|---|---|
| **Practical expedient to assume current conditions do not change** | Any entity is permitted to assume current conditions as of the balance sheet date do not change for the remaining life of current accounts receivable and current contract assets. |
| **Accounting policy to consider subsequent collection activity (non-PBEs only)** | An entity that is not a PBE is permitted to consider collection activity after the balance sheet date if it has also elected the practical expedient to assume current conditions have not changed. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 10.2 Collateral-dependent financial assets

### Excerpt from ASC 326-20

• > Collateral-Dependent Financial Assets

**35-4** Regardless of the initial measurement method, an entity shall measure expected credit losses based on the **fair value** of the collateral at the reporting date when the entity determines that foreclosure is probable. The entity shall adjust the fair value of the collateral for the estimated costs to sell if it intends to sell rather than operate the collateral. When an entity determines that foreclosure is probable, the entity shall remeasure the **financial asset** at the fair value of the collateral at the reporting date (less costs to sell, if applicable) so that the reporting of a credit loss is not delayed until actual foreclosure. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses. An allowance for credit losses that is added to the **amortized cost basis** of the financial asset(s) shall not exceed amounts previously written off.

**35-5** An entity may use, as a practical expedient, the fair value of the collateral at the reporting date when recording the net carrying amount of the asset and determining the allowance for credit losses for a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date (collateral-dependent financial asset). If an entity uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral shall be adjusted for estimated costs to sell. However, the entity shall not incorporate in the net carrying amount of the financial asset the estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral. When the fair value (less costs to sell, if applicable) of the collateral at the reporting date exceeds the amortized cost basis of the financial asset, an entity shall adjust the allowance for credit losses to present the net amount expected to be collected on the financial asset equal to the fair value (less cost to sell, if applicable) of the collateral as long as the allowance that is added to the amortized cost basis of the financial asset(s) does not exceed amounts previously written off. If the fair value of the collateral is less than the amortized cost basis of the financial asset for which the practical expedient has been elected, an entity shall recognize an allowance for credit losses on the collateral-dependent financial asset, which is measured as the difference between the fair value of the collateral, less costs to sell (if applicable), at the reporting date and the amortized cost basis of the financial asset. An entity also shall consider any credit enhancements that meet the criteria in paragraph 326-20-30-12 that are applicable to the financial asset when recording the allowance for credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Excerpt from ASC 326-20

• > Example 6: Estimating Expected Credit Losses—Practical Expedient for Collateral-Dependent Financial Assets

**55-41** This Example illustrates one way an entity may implement the guidance in paragraph 326-20-35-5 for estimating expected credit losses on a collateral-dependent financial asset for which the borrower is experiencing financial difficulty based on the entity's assessment.

**55-42** Bank F provides commercial real estate loans to developers of luxury apartment buildings. Each loan is secured by a respective luxury apartment building. Over the past two years, comparable standalone luxury housing prices have dropped significantly, while luxury apartment communities have experienced an increase in vacancy rates.

**55-43** At the end of 20X7, Bank F reviews its commercial real estate loan to Developer G and observes that Developer G is experiencing financial difficulty as a result of, among other things, decreasing rental rates and increasing vacancy rates in its apartment building.

**55-44** After analyzing Developer G's financial condition and the operating statements for the apartment building, Bank F believes that it is unlikely Developer G will be able to repay the loan at maturity in 20X9. Therefore, Bank F believes that repayment of the loan is expected to be substantially through the foreclosure and sale (rather than the operation) of the collateral. As a result, in its financial statements for the period ended December 31, 20X7, Bank F utilizes the practical expedient provided in paragraph 326-20-35-5 and uses the apartment building's fair value, less costs to sell, when developing its estimate of expected credit losses.

### 10.2.10 Overview

A financial asset is collateral-dependent when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. [326-20-35-4]

The collateral-dependent practical expedient is applied when:

- **Foreclosure is probable.** An entity uses the collateral's fair value at the reporting date to estimate the financial asset's expected credit losses.
- **The financial asset is collateral-dependent but foreclosure is not probable.** An entity can elect to apply the practical expedient to use the collateral's fair value at the reporting date to estimate the asset's expected credit losses.

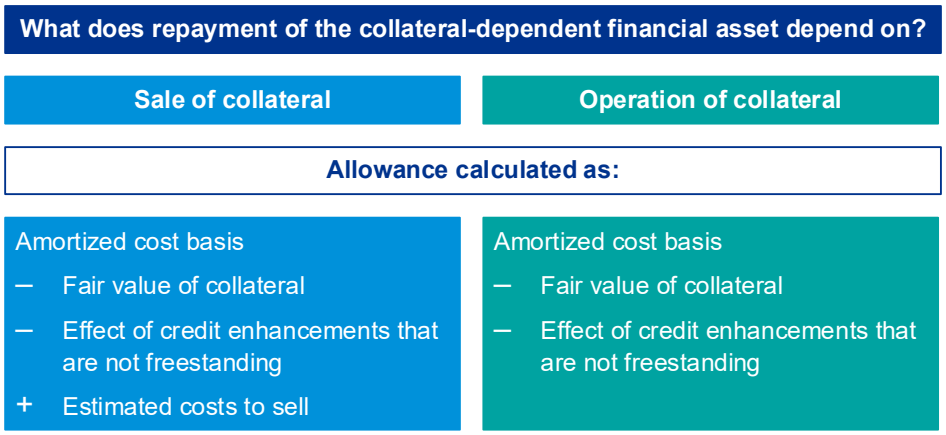
If the financial asset was previously written off (either partially or fully) and the collateral's fair value at the reporting date is greater than the amortized cost, an entity adjusts the allowance to present the net amount expected to be collected. However, the allowance that is added to the amortized cost may not exceed amounts previously written off. [326-20-35-4 – 35-5]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

If the entity chooses not to elect the practical expedient or the practical expedient does not apply, it uses the general measurement principles in Subtopic 326-20 to estimate the allowance for credit losses. [326-20-35-4 – 35-5]

### *Calculation of allowance for credit losses*

There is no difference in the calculation of expected credit losses when use of the practical expedient is mandatory versus elective. How expected credit losses are calculated in both instances depends on whether repayment of the financial asset is expected to be from the sale or the operation of the collateral. The following decision tree summarizes how an allowance for credit losses is calculated based on the expected source of repayment.




Either calculation may result in a zero, positive, or negative amount. Any negative allowance may not exceed the amount of previous writeoffs.

## 10.2.20 Scope

The collateral-dependent practical expedient must be applied when foreclosure is probable. Further, it may be elected when foreclosure is not probable but:

- repayment is expected to be provided substantially through the operation or sale of the collateral; and
- the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date. [326-20-35-4 – 35-5]

**Question 10.2.45** If foreclosure is not probable, can the practical expedient be applied regardless of which party will operate the collateral?

**Interpretive response:** Yes. When repayment or satisfaction of the financial asset depends on the operation (rather than on the sale) of the collateral, we believe the practical expedient can be applied regardless of which party (lender, borrower or third party) will operate the property. [326-20-35-5]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 10.2.50** How does an entity determine if the debtor is experiencing financial difficulty?

### Excerpt from ASC 310-10

• > Determining Whether a Debtor Is Experiencing Financial Difficulty

**50-45** In evaluating whether the debtor is experiencing financial difficulties for the purpose of the disclosure requirements in paragraphs 310-10-50-42 through 50-44 , a creditor shall consider the following indicators:

a. The debtor is currently in payment default on any of its debt. In addition, a creditor shall evaluate whether it is probable that the debtor would be in payment default on any of its debt in the foreseeable future without the modification. That is, a creditor may conclude that a debtor is experiencing financial difficulties, even though the debtor is not currently in payment default.
b. The debtor has declared or is in the process of declaring bankruptcy.
c. There is substantial doubt as to whether the debtor will continue to be a going concern.
d. The debtor has securities that have been delisted, are in the process of being delisted, or are under threat of being delisted from an exchange.
e. On the basis of estimates and projections that only encompass the debtor's current capabilities, the creditor forecasts that the debtor's entity-specific cash flows will be insufficient to service any of its debt (both interest and principal) in accordance with the contractual terms of the existing agreement for the foreseeable future.
f. Without the current modification, the debtor cannot obtain funds from sources other than the existing creditors at an effective interest rate equal to the current market interest rate for similar debt for a nontroubled debtor.

The above list of indicators is not intended to include all indicators of a debtor's financial difficulties.

**Interpretive response:** Subtopic 310-10 provides indicators for determining whether a borrower is experiencing financial difficulty when evaluating whether incremental disclosures are required about a loan modification. We believe those indicators may be applied by analogy when considering whether the practical expedient for collateral-dependent financial assets can be elected. [310-10-50-45]

## **Example 10.2.05** Evaluating whether the debtor is experiencing financial difficulties

Developer is a private company builder of apartment buildings and strip malls. To finance the construction of one of its apartment complexes, on April 1, Year 1 it obtains a 15-year loan for $20 million at 7.5% interest from Bank. Interest reserves are established to provide interest-only payments during the two-year construction period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

As of January 1, Year 3, construction has not been completed and three months of interest reserves remain. There are commitments to lease 75% of the building's space, but based on current projections rental receipts will not be sufficient to service the loan unless the building is leased up to at least 90%.

Developer's financial statements for the last two years show approximately break-even net income and operating cash flows. Current financial statements indicate that Developer has minimal other resources available to support this debt. Because the project has not been completed, Developer cannot obtain take-out or permanent financing.

Bank concludes that Developer is experiencing financial difficulties for the following reasons:

- Developer is not expected to have sufficient cash flows to service the debt in accordance with the original contractual terms;
- Developer cannot obtain take-out financing from another lender; and
- Developer's repayment capacity is uncertain and it has weak financial support.

### **Question 10.2.60** Once an entity has elected the practical expedient when foreclosure is not probable, must it reassess the expedient's applicability in subsequent periods?

**Interpretive response:** Yes. If foreclosure is not probable, we believe for an entity to continue to apply the practical expedient, the borrower should continue to be experiencing financial difficulty and the entity should continue to expect repayment to be provided substantially through the collateral's sale or operation. If one or both of these conditions no longer exist and foreclosure is not probable, another acceptable method should be used to estimate expected credit losses. [326-20-35-4 – 35-5]

An entity will need to use judgment and develop processes and controls to determine at what point a borrower that was previously experiencing financial difficulty has overcome that financial difficulty.

## 10.2.30 Measurement

If on the reporting date an entity (1) determines that foreclosure of a collateral-dependent financial asset is probable or (2) elects the practical expedient, it estimates the asset's expected credit losses based on the fair value of the collateral at the reporting date and records any resulting credit losses at that time. This requirement prevents the entity from delaying recognition of the credit losses until foreclosure occurs. [326-20-35-4]

- **Fair value of collateral is less than amortized cost.** If the fair value of the underlying collateral at the reporting date – adjusted for estimated costs to sell, if applicable – is less than the amortized cost of the financial asset, the resulting difference is the allowance for credit losses. The fair value of the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

underlying collateral is not reduced by estimated costs to sell when repayment is expected to come from operation rather than sale of the collateral. [326-20-35-4]

- **Fair value of collateral is greater than amortized cost.** If the financial asset has previously had a full or partial write off and the fair value of the underlying collateral at the reporting date – adjusted for estimated costs to sell, if applicable – is greater than the amortized cost, the allowance for credit losses is adjusted to present the net amount expected to be collected. However, the allowance for credit losses that is added to the amortized cost may not exceed amounts previously written off. [326-20-35-4 – 35-5]

Further, an entity considers credit enhancements that are not freestanding when estimating expected credit losses. Chapter 9 discusses credit enhancements in greater detail.

## **Example 10.2.10** Application of the practical expedient when the debtor operates the property

Bank loans ABC Corp. $20 million on January 1, Year 1. The loan is secured by commercial real estate that has a fair value at origination of $25 million. The primary source of repayment of the loan is rent collected from the property's tenants.

In April, Year 4, ABC informs Bank that it has lost the anchor tenant and current rent projections do not support the loan payments. ABC has made no payments for two months and Bank has adversely classified the loan.

Bank obtains an updated appraisal as of June 30, Year 4, indicating that the real estate's fair value is now $15 million, compared with the remaining amortized cost of the loan of $19 million.

Bank does not intend to foreclose on the property. It believes that cash flows will be maximized by allowing ABC to continue to operate the commercial real estate and attempt to secure a new anchor tenant.

At June 30, Year 4, Bank determines that repayment of the loan is expected to be substantially through ABC's operation of the collateral and that ABC is experiencing financial difficulty. Therefore, Bank elects the practical expedient to measure the loan's expected credit losses.

Bank estimates that the allowance for credit losses is $4 million at June 30, Year 4: loan's remaining amortized cost of $19 million less fair value of the collateral of $15 million (which does not consider costs to sell).

## **Question 10.2.65** What types of costs are considered in estimated selling costs?

**Interpretive response:** We believe costs to sell represent incremental direct costs to transact a sale. Incremental direct costs are costs that result directly

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

from, and are essential to, a sale transaction and that would not have been incurred if the entity had not sold the asset.

An entity needs to evaluate whether costs such as broker commissions, legal and transfer fees, and closing costs to transfer legal title are expected to be incurred solely because the asset was sold. Further, expenses that an entity anticipates paying on behalf of the borrower that are associated with owning and operating the asset (e.g. taxes and insurance) are not considered costs to sell.

## **Question 10.2.70** Is the practical expedient applied at the individual financial asset level?

**Interpretive response:** Yes. We believe an entity should apply the practical expedient at the individual financial asset level.

Applying the practical expedient at the portfolio level could inappropriately allow expected credit losses from financial assets for which the fair value of the collateral is less than the amortized cost to be offset by gains from those financial assets for which the fair value of the collateral is greater than the amortized cost. [326-20-35-5]

## **Question 10.2.80** Are credit enhancements considered when estimating expected credit losses using the practical expedient?

**Interpretive response:** Yes, when applying the practical expedient an entity also considers credit enhancements that are not freestanding when estimating expected credit losses for collateral-dependent financial assets. [326-20-35-5]

Chapter 9 discusses credit enhancements in greater detail.

## **Question 10.2.85** How does an entity account for a subsequent increase in the fair value of the collateral?

**Interpretive response:** A subsequent increase in the fair value of the underlying collateral – adjusted for estimated costs to sell, if applicable – above the financial asset's amortized cost is first reflected as a reduction in the allowance for credit losses, if any. The allowance for credit losses may be negative (i.e. a debit balance) if the financial asset had previously had a full or partial write off. However, the negative allowance is limited to the amount of previous writeoffs. [326-20-35-4 – 35-5]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 10.2.20** Increase in fair value of collateral after a previous writeoff

Bank loans ABC Corp. $10 million on January 1, Year 1. The loan is secured by commercial real estate that has a fair value at origination of $11 million.

In Year 2, Bank determines that the loan is collateral-dependent and applies the practical expedient when measuring the related allowance for credit losses. Therefore, the loan's allowance for credit losses is based on the collateral's fair value. Bank obtains an updated appraisal as of the end of Year 2 indicating that the fair value of the collateral securing the loan is $8 million. For simplicity, assume that amortized cost is $10 million at the end of Year 2 and there are no costs to sell.

Bank estimates that the allowance for credit losses is $2 million at the end of Year 2, which is the difference between the fair value of the collateral ($8 million) and the loan's amortized cost ($10 million). Further, Bank determines that $2 million of the remaining $10 million is uncollectible and writes off the $2 million allowance and related loan balance.

Bank continues to monitor the fair value of the collateral and obtains an updated appraisal as of the end of Year 3, which indicates that the fair value of the collateral is $12 million. Bank recognizes an adjustment to the allowance for credit losses related to the subsequent increase in the fair value of the collateral. Although the excess of fair value of the collateral over amortized cost is $4 million, the negative allowance that is recognized is only $2 million because it is limited to the amount previously written off.

## **Question 10.2.90** When a loan is considered collateral-dependent, must an entity use the fair value of collateral to estimate expected credit losses for bank regulatory reporting purposes?

**Interpretive response:** Yes. For bank regulatory reporting purposes, consistent with existing guidance, an entity is required to estimate expected credit losses based on the fair value of the collateral for loans held-for-investment that individually meet the definition of collateral-dependent financial assets regardless of whether foreclosure is probable. This requirement is specific to loans held-for-investment and does not extend to other financial assets in the scope of Subtopic 326-20 (such as HTM debt securities). [Agency FAQs #37]

If foreclosure on held-for-investment loans is not probable, differences could result between bank regulatory and US GAAP reporting if the entity does not elect Subtopic 326-20's practical expedient for US GAAP reporting purposes. These differences will result because when an entity does not elect the practical expedient under Subtopic 326-20, it applies that Subtopic's general guidance on estimating credit losses. However, the Bank regulatory guidance may effectively prohibit the use of this general guidance in Subtopic 326-20 in these circumstances. [326-20-35-4 – 35-5, Agency FAQs #37]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

This scenario was raised by the SEC staff in a speech at the 2017 AICPA Conference on Current SEC and PCAOB Developments. A registrant sought the staff's view on whether it could apply the general guidance on determining expected credit losses for US GAAP financial reporting, as opposed to the practical expedient, for collateral-dependent financial assets when foreclosure is not deemed probable. The staff indicated they would not object to a registrant's decision to apply the general expected credit loss approach. [2017 AICPA Conf]

## **Question 10.2.95** Do expected credit losses include amounts anticipated to be collected from a borrower after foreclosure or repossession when the lender applies the collateral dependent practical expedient?

**Background:** A loan may provide the lender with the contractual right to continue to pursue payments from the borrower after foreclosure or repossession. In some cases, the entity's past experience and future expectation is that it will continue to pursue collection from the borrower and receive payments after foreclosure or repossession.

For certain of these loans, the allowance will be estimated using the collateral dependent practical expedient – e.g. when foreclosure or repossession of the collateral-dependent loan is probable.

**Interpretive response:** No. However, an entity should consider anticipated collections from a borrower after foreclosure or repossession for a loan for which the collateral dependent practical expedient was applied before foreclosure or repossession of the collateral occurred.

The following table summarizes when anticipated collections from a borrower in these circumstances should be considered in estimating expected credit losses.

| Allowance is estimated prior to foreclosure or repossession | Allowance is estimated subsequent to foreclosure or repossession |
|---|---|
| Do not consider. Because the practical expedient is applied, the allowance is the difference between the fair value (adjusted for estimated cost to sell) and the amortized cost with no additional adjustments. Further, the anticipated collections are not considered a credit enhancement as contemplated in paragraph 326-20-30-12. [326-20-35-4] | Consider. Because the loan is no longer collateral-dependent after foreclosure or repossession, the practical expedient cannot be applied. We believe that if an entity retains the contractual right to continue to pursue collection and receive payments from the borrower after foreclosure or repossession, and those amounts have been written off, the anticipated collections are considered as anticipated recoveries in estimating the allowance for credit losses. However, estimated recoveries are limited to amounts previously written off (see section 3.3.10). [326-20-30-1] |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 10.2.30** Estimating the allowance before repossession

Bank makes a direct auto loan to Borrower for $80,000 on January 1, Year 1. The loan is secured by a vehicle that has a fair value at origination of $100,000.

In Year 2, Bank determines that the loan is collateral-dependent. Bank applies the practical expedient when measuring the related allowance for credit losses because repossession is probable.

When Bank repossesses the vehicle, it retains the right to continue to pursue payments from Borrower. That right comes from the original loan agreement, which continues to exist and continues to be enforceable. Bank's past experience demonstrates that it will collect amounts after repossession.

In Year 2, Bank's estimates are as follows.

| | |
|---|---|
| Amortized cost: | 70,000 |
| Fair value of collateral: | 50,000 |
| Anticipated collections from Borrower after repossession: | 10,000 |
| Estimated costs to sell: | 1,000 |

Bank estimates the allowance for credit losses at $21,000 at the end of Year 2, which is the difference between the fair value of the collateral ($50,000) adjusted for estimated costs to sell ($1,000) and the loan's amortized cost ($70,000).

Bank does not consider anticipated collections in the calculation because the practical expedient is applied.

## **Example 10.2.35** Estimating the allowance after repossession

This example uses the facts in Example 10.2.30 except that the following events occur at the end of Year 2.

- Immediately before repossession, Bank writes off the allowance for credit losses and the related loan balance.
- Bank repossesses the vehicle associated with the loan. The collateral is classified as a repossessed asset and measured at the lower of cost or fair value less costs to sell.
- After repossession, Bank sells the vehicle and is left with a shortfall.

After repossession, Bank retains the right to continue to pursue payments from Borrower and expects to collect $10,000 based on its past experience adjusted for specific facts and circumstances. As a result, Bank recognizes a negative allowance of $10,000, which represents the expected recovery.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 10.2.100** Can an entity use liquidation value to estimate expected credit losses for a collateral-dependent financial asset, if different from fair value?

**Background:** In the context of this question, liquidation value refers to the amount the seller expects to collect from the sale of the asset. In many cases, the liquidation value and the fair value will be the same, but not in all cases.

**Interpretive response:** No. An entity determines the value of the underlying collateral of a collateral-dependent financial asset using a fair value measurement (Topic 820). The Board deliberated whether the collateral-dependent practical expedient should be based on liquidation value instead of fair value, but it decided to retain the fair value measurement concept because fair value is well understood and applied in current practice. Therefore, when the liquidation value and the fair value of the underlying collateral are different, the entity must use the fair value. [326-20 Glossary, ASU 2016-13.BC65]

We believe that if an entity observes a pattern of significant differences between the appraised value for a foreclosed property and the amount ultimately realized on its sale (the liquidation value), an entity should perform a retrospective review and investigate the reason(s) for the difference – e.g. the appraiser did not contemplate that the property was a foreclosed property. The results of that review can be used to determine whether the entity should incorporate changes to its fair value estimation process, including considering the potential need to adjust the appraised values used to measure the allowance for credit losses for other collateral-dependent financial assets (i.e. that have not yet been foreclosed upon).

However, an adjustment to appraised value will not always be appropriate. For example, the appraisal value would not be adjusted if the difference is solely because the appraisal assumed a marketing period or practices that are customary for the type of asset being sold while the actual sale occurred in a marketing period that was shorter or less robust. This is because a fair value measurement is based on an orderly transaction, and orderly transactions involve the use of a marketing period or practices that are customary for the type of asset being sold. [820-10-35-54(I)(a)]

## 10.3 Collateral maintenance provisions

### Excerpt from ASC 326-20

> Financial Assets Secured by Collateral Maintenance Provisions

**35-6** For certain **financial assets**, the borrower may be contractually required to continually adjust the amount of the collateral securing the financial assets as a result of **fair value** changes in the collateral. In those situations, if an entity reasonably expects the borrower to continue to replenish the collateral to meet the requirements of the contract, an entity may use, as a practical expedient, a method that compares the **amortized cost basis** with the fair value of collateral at the reporting date to measure the estimate of expected

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

credit losses. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the fair value of the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral as necessary to meet the requirements of the contract. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset and the entity reasonably expects the borrower to continue to replenish the collateral as necessary to meet the requirements of the contract, the entity shall estimate expected credit losses for the unsecured amount of the amortized cost basis. The allowance for credit losses on the financial asset is limited to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.

• > Example 7: Estimating Expected Credit Losses – Practical Expedient for Financial Assets with Collateral Maintenance Provisions

**55-45** This Example illustrates one way an entity may implement the guidance in paragraph 326-20-35-6 for estimating expected credit losses on financial assets with collateral maintenance provisions.

**55-46** Bank H enters into a reverse repurchase agreement with Entity I that is in need of short-term financing. Under the terms of the agreement, Entity I sells securities to Bank H with the expectation that it will repurchase those securities for a certain price on an agreed-upon date. In addition, the agreement contains a provision that requires Entity I to provide security collateral that is valued daily, and the amount of the collateral is adjusted up or down to reflect changes in the fair value of the underlying securities transferred. This collateral maintenance provision is designed to ensure that at any point during the arrangement, the fair value of the collateral continually equals or is greater than the amortized cost basis of the reverse repurchase agreement.

**55-47** At the end of the first reporting period after entering into the agreement with Entity I, Bank H evaluates the reverse repurchase agreement's collateral maintenance provision to determine whether it can use the practical expedient in accordance with paragraph 326-20-35-6 for estimating expected credit losses. Bank H determines that although there is a risk that Entity I may default, Bank H's expectation of nonpayment of the amortized cost basis on the reverse repurchase agreement is zero because Entity I continually adjusts the amount of collateral such that the fair value of the collateral is always equal to or greater than the amortized cost basis of the reverse repurchase agreement. In addition, Bank H continually monitors that Entity I adheres to the collateral maintenance provision. As a result, Bank H uses the practical expedient in paragraph 326-20-35-6 and does not record expected credit losses at the end of the first reporting period because the fair value of the security collateral is greater than the amortized cost basis of the reverse repurchase agreement. Bank H performs a reassessment of the fair value of collateral in relation to the amortized cost basis each reporting period.

Certain arrangements require the borrower to continually adjust the amount of collateral securing the financial asset as a result of changes in the fair value of the collateral. Subtopic 326-20 refers to these arrangements as collateral maintenance provisions.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

For these types of arrangements, when the borrower is expected to replenish the collateral as required by the terms of the agreement, Subtopic 326-20 permits (but does not require) the use of a practical expedient to estimate expected credit losses. Under this practical expedient, an entity estimates expected credit losses for any difference between the financial asset's amortized cost basis and the fair value of collateral securing the financial asset. This means that if the amortized cost basis is greater, the entity estimates expected credit losses for the unsecured portion of the amortized cost. [326-20-35-6]

## **Question 10.3.10** To apply the practical expedient, does an entity need to assess whether the borrower will replenish the collateral?

**Interpretive response:** Yes. To apply the practical expedient, an entity needs to assess whether the borrower will replenish the collateral.

The entity only needs to assess whether it has a *reasonable expectation* that the borrower will be able to replenish collateral, if necessary. The Board clarified in the basis for conclusions that the entity would not need to either: [ASU 2019-11.BC23]

- assess whether it is probable that the borrower will replenish collateral, if necessary; or
- consider remote scenarios where the borrower may not be able to replenish the collateral.

## **Question 10.3.15** What should an entity consider when evaluating whether a borrower is required to continually adjust the amount of collateral?

**Interpretive response:** We believe an entity should consider the following two factors when evaluating whether a borrower is required to continually adjust the amount of collateral securing the financial asset:

- how frequently the collateral is required to be replenished; and
- the liquidity of the collateral.

Although this is a judgment-based determination that depends on facts and circumstances, we believe the term 'continually' implies a frequency that would generally align with daily or weekly adjustments to the amount of collateral securing the financial asset.

We further believe that the liquidity of the collateral should be considered. We believe that illiquidity of the collateral may indicate that the borrower is either not required to continually replenish, or may not be able to replenish, the collateral securing the financial asset.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 10.3.20** How does an entity apply the practical expedient when the fair value of the collateral is equal to or greater than the amortized cost basis?

**Interpretive response:** If the fair value of the collateral at the reporting date is equal to or greater than the amortized cost of the financial asset, an entity does not recognize an allowance for credit losses. Further, we believe the entity does not need to consider the possibility of the collateral declining in value after the reporting date. [326-20-35-6]

## **Question 10.3.30** How does an entity apply the practical expedient when the fair value of the collateral is less than the amortized cost basis?

**Interpretive response:** If the fair value of the collateral at the reporting date is less than the amortized cost of the financial asset, an entity should evaluate the financial asset as two separate components.

For the portion of the financial asset that is collateralized, the entity does not recognize an allowance for credit losses.

For the portion of the financial asset that is uncollateralized, the entity should use the general guidance on estimating expected credit losses (see chapter 4). The maximum amount of expected credit losses is capped at the amount that is uncollateralized (that is, it is limited to the difference between the fair value of the collateral at the reporting date and the amortized cost).

## **Example 10.3.10** Repurchase agreement

ABC Corp. transfers securities that have a fair value of $1,000 to XYZ Corp. as collateral in exchange for $1,000 in cash. ABC agrees to repurchase the securities from XYZ in 90 days.

The transaction is accounted for by ABC as a secured borrowing (repurchase agreement), and not a sale of a security. Similarly, XYZ accounts for the transaction as a secured borrowing (reverse repurchase) and not a purchase of a security.

ABC is contractually required to maintain collateral with a fair value that ranges between 98–102% of the cash borrowed. If the fair value of the collateral falls below 98%, ABC is required to provide XYZ with additional collateral.

XYZ has determined that it may apply the practical expedient related to collateral maintenance provisions.

XYZ elects to apply the practical expedient for collateral maintenance provisions, and uses a probability of default/loss given default method to estimate losses on any uncollateralized amounts. XYZ estimates that the probability of default is 15% and the loss given default is 60%.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

At December 31, the fair value of the collateral has declined to $980. XYZ determines the allowance for credit losses for the $1,000 reverse repurchase agreement as follows.

- For the portion of the financial asset that is collateralized ($980), XYZ does not recognize an allowance for credit losses.
- For the portion of the financial asset that is uncollateralized ($20), XYZ calculates its allowance for credit losses as $20 × 15% × 60% = $1.80.

## 10.4 Current accounts receivable and contract assets**

### 10.4.10 Overview

**Excerpt from ASC 326-20**

• > Practical Expedient and Accounting Policy Election for Current Accounts Receivable and Current Contract Assets

**30-10A** An entity may elect the practical expedient described in paragraphs 326-20-30-10C through 30-10D and an entity other than a public business entity may elect the accounting policy described in paragraphs 326-20-30-10E through 30-10H when developing an estimate of expected credit losses on current accounts receivable and current **contract asset** balances arising from transactions accounted for under Topic 606 on revenue from **contracts** with **customers**. This includes those asset balances acquired in a transaction accounted for under Topic 805 on business combinations or recognized through the consolidation of a variable interest entity that is not a business as described in paragraph 810-10-30-3 that arose from transactions that the acquiree or variable interest entity accounted for under Topic 606.

**30-10B** When elected, the practical expedient and accounting policy election shall be applied consistently to all current accounts receivable and current contract assets described in paragraph 326-20-30-10A. When determining whether an accounts receivable or contract asset balance is a **current asset**, an entity should use a one-year period unless an entity's **operating cycle** exceeds 12 months, in which case the longer period shall be used (see paragraph 210-10-45-3)

Subtopic 326-20 provides two simplifications that can be used when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers).

| Simplification | Summary |
|---|---|
| **Practical expedient to assume current conditions do not change**<br>See section 10.4.20 | Any entity is permitted to assume current conditions as of the balance sheet date do not change for the remaining life of current accounts receivable and contract assets. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Simplification | Summary |
|---|---|
| **Accounting policy to consider subsequent collection activity**<br>See section 10.4.30 | An entity that is not a PBE is permitted to consider collection activity after the balance sheet date if it has also elected the practical expedient to assume current conditions have not changed. |

## **Question 10.4.10** What assets are in scope of the simplifications?

**Interpretive response:** The simplifications are available when estimating expected credit losses for current accounts receivable and contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers); see KPMG Handbook, Revenue recognition. When determining whether an asset is current, an entity should generally use a one-year period unless its operating cycle exceeds 12 months, in which case the longer operating cycle applies; see section 3.3. of KPMG Handbook, Financial statement presentation. [210-10-45-3, 326-20-30-10A – 30-10B]

## **Question 10.4.20** Do the simplifications apply to current accounts receivable and contract assets that are acquired?

**Interpretive response:** Yes, when those assets arose from transactions that were accounted for under Topic 606.

Subtopic 326-20 specifies that it applies to assets acquired in a transaction accounted for as a business combination (under Topic 805) or recognized through consolidation of a variable interest entity (VIE) that is not a business (as described in paragraph 810-10-30-3) if the balances arose from transactions that the acquiree or VIE accounted for under Topic 606. [326-20-30-10A]

Similarly, we believe the simplifications apply to current accounts receivable and contract assets acquired through other types of asset acquisitions – such as assets acquired in transactions accounted for under Subtopic 805-50 or Topic 860 – if the acquired assets arose from transactions originally accounted for under Topic 606. This is consistent with the Board's intent in including acquired assets in the simplified guidance, which was to allow companies to apply Topic 326 consistently to assets regardless of whether they were acquired or originated. [326-20-30-10A, ASU 2025-05.BC20-BC21]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 10.4.30** Are the simplifications to be applied consistently to current contract receivables and contract assets?

**Interpretive response:** Yes. When elected, the simplified credit loss guidance is to be applied consistently over time to current contract receivables and current contract assets. [326-20-30-10B]

## 10.4.20 Practical expedient to assume current conditions do not change

### Excerpt from ASC 326-20

• • > Practical Expedient

**30-10C** For assets described in paragraph 326-20-30-10A, an entity may elect a practical expedient to assume that current conditions as of the balance sheet date do not change for the remaining life of the asset.

**30-10D** When developing an estimate of expected credit losses for assets to which the practical expedient is applied, an entity shall continue to adjust historical loss information to reflect current conditions to the extent that historical loss information does not reflect current conditions. For example, an entity that has identified an individual customer that is experiencing financial distress would consider that information in its estimate of expected credit losses for that customer even if that information has not yet affected its historical loss experience (that is, even if the customer has not defaulted as of the balance sheet date). Similarly, an entity that has expanded its credit policies before the balance sheet date to offer credit to lower-credit-quality customers would consider that information in its estimate of expected credit losses even if that change has not yet affected its historical loss experience (that is, even if the new, lower-credit-quality customers have not defaulted as of the balance sheet date). As another example, if an entity determined that economic conditions as of the balance sheet date were different from the conditions that existed over the period during which historical data were collected because of the onset of a severe economic recession before the balance sheet date, the entity should consider whether an adjustment to historical loss information is necessary. See paragraph 326-20-50-12A for related disclosure requirements and paragraphs 326-20-55-40A through 55-40Q for an illustrative Example.

### **Question 10.4.40** What is the practical expedient to assume current conditions do not change?

**Background:** As explained in chapter 7, historical loss experience is generally the starting point for estimating expected credit losses. Adjustments are made to historical loss experience to reflect differences in asset-specific risk

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

characteristics and in economic conditions – both current conditions and reasonable and supportable forecasts of future economic conditions.

**Interpretive response:** The practical expedient allows an entity to assume that current conditions as of the balance sheet date do not change for the remaining life of the asset. Therefore, an entity will not need to develop reasonable and supportable forecasts of future economic conditions to estimate expected credit losses for current accounts receivable and contract assets. [326-20-30-10C]

## **Question 10.4.50** What entities are in the scope of the practical expedient to assume current conditions do not change?

**Interpretive response:** All entities are eligible to elect the practical expedient. [326-20-30-10C]

## **Question 10.4.60** Does the practical expedient permit an entity to assume current conditions as of the balance sheet date are the same as in historical periods?

**Interpretive response:** No. The expedient only eliminates the need to forecast future economic conditions when developing an estimate of expected credit losses. It does not permit an entity to assume current conditions are the same as in the historical period(s) used for obtaining historical loss experience (see section 7.2.30). [326-20-30-10D]

Therefore, an entity is required to adjust historical loss information if it does not reflect current conditions. Paragraph 326-20-30-10D provides the following examples of when an entity applying the practical expedient would make adjustments to its historical loss experience for differences between current conditions and those in historical period(s) used for obtaining historical loss experience.

- An entity has identified an individual customer that is experiencing financial distress that is not reflected in its historical loss experience.
- An entity has expanded its credit policies before the balance sheet date to offer credit to lower-credit-quality customers and that change has not yet affected its historical loss experience.
- An entity has determined that economic conditions as of the balance sheet date were different from the conditions that existed in the historical period(s) used for obtaining historical loss experience because of the onset of a severe economic recession before the balance sheet date.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 10.4.30 Accounting policy to consider subsequent collection activity

### Excerpt from ASC 326-20

• • > Accounting Policy Election

**30-10E** An entity other than a **public business entity** that elects the practical expedient in paragraphs 326-20-30-10C through 30-10D may also elect an accounting policy when estimating expected credit losses to consider collection activity after the balance sheet date but before the entity's **financial statements are available to be issued** (or before any alternative date selected by the entity that is after the balance sheet date but before the financial statements are available to be issued). For example, under this accounting policy election, the allowance for credit losses related to those asset balances described in paragraph 326-20-30-10A that are collected before an entity's financial statements are available to be issued (or before the alternative date selected by the entity) would be zero. See paragraphs 326-20-50-12A through 50-12B for specific disclosure requirements applicable to this accounting policy election.

**30-10F** An entity other than a public business entity that applies the practical expedient and the accounting policy election shall estimate its expected credit losses on current accounts receivable and current contract asset balances in the following sequence:

a. The entity shall first consider subsequent collections of those asset balances described in paragraph 326-20-30-10A that were outstanding as of the balance sheet date. No credit loss allowance shall be recorded for asset balances that have been collected before the financial statements are available to be issued (or before the alternative date selected by the entity).
b. The entity shall then evaluate any remaining uncollected amounts as of the date that the financial statements are available to be issued (or as of the alternative date selected by the entity) using the practical expedient in paragraphs 326-20-30-10C through 30-10D. That evaluation shall be based on the delinquency status of those uncollected balances as of the date that the financial statements are available to be issued (or the alternative date selected by the entity). See paragraphs 326-20-55-40J through 55-40Q for an illustrative Example.

**30-10G** For entities estimating expected credit losses using an aging schedule (as illustrated in paragraphs 326-20-55-37 through 55-40Q), an entity other than a public business entity that elects to consider subsequent collection activity is permitted, but not required, to update historical loss rates for collection activity after the balance sheet date when determining the allowance for credit losses for amounts outstanding as of the balance sheet date that remain uncollected as of the date that the financial statements are available to be issued (or the alternative date selected by the entity).

**30-10H** A change in the date through which an entity considers subsequent collection activity when applying the accounting policy election is not a change

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

in an accounting principle in accordance with Topic 250 on accounting changes and error corrections.

## **Question 10.4.70** What is the accounting policy that permits an entity to consider subsequent collection activity?

**Interpretive response:** Under this simplification, an entity elects an accounting policy to estimate its expected credit losses for current accounts receivable and contract assets considering collection activity that occurs:

- after the balance sheet date, but
- before the earlier of the following dates:
  - the date the entity's financial statements are available to be issued; or
  - any alternative date selected by the entity.

This accounting policy may be elected only if the practical expedient to assume current conditions do not change (see section 10.4.20) is also elected. [326-20-30-10E]

## **Question 10.4.80** What entities are in the scope of the accounting policy to consider subsequent collection activity?

**Interpretive response:** The accounting policy to consider subsequent collection activity may only be elected by entities other than PBEs. Additionally, it may only be elected if the practical expedient to assume current conditions do not change is also elected (see section 10.4.20). [326-20-30-10E]

## **Question 10.4.90** How is the accounting policy to consider subsequent collection activity applied?

**Interpretive response:** An entity applying the practical expedient uses the following two-step process. [326-20-30-10E – 30-10F]

| | |
|---|---|
| **Step 1** | Consider subsequent collections of current accounts receivable and contract asset balances that were outstanding as of the balance sheet date.<br>No allowance for credit losses is recognized as of the balance sheet date for outstanding asset balances that were collected before the financial statements are available to be issued (or before the alternative date selected by the entity). |
| **Step 2** | Evaluate balances that remain uncollected as of the financial statement issuance date (or alternative date selected). |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | |
|---|---|
| | An allowance for credit losses is estimated based on delinquency status as of the date through which subsequent collection activity is considered. |

### **Question 10.4.100** Can an entity consider subsequent collection activity in historical loss rates applied to remaining uncollected assets?

**Background:** An entity estimates expected credit losses for uncollected amounts based on their delinquency status as of the date through which subsequent collection activity is considered (see Question 10.4.90).

**Interpretive response:** Yes, if the entity uses an aging schedule to estimate expected credit losses (as illustrated in sections 7.4 and 18.3), it may – but is not required to – update historical loss rates for collection activity after the balance sheet date. Entities using other methods to estimate credit losses cannot update the historical loss rates. [326-20-30-10G]

### **Question 10.4.110** Is it a change in accounting principle to change the date through which subsequent collection activity is considered?

**Background:** As explained in Question 10.4.70, an entity electing to consider subsequent collection activity can choose to consider collection activity through either the date its financial statements are available to be issued or an earlier date.

**Interpretive response:** No. Subtopic 326-20 specifies that a change in the date through which subsequent collection activity is considered is not a change in accounting principle. [326-20-30-10H]

## 10.4.40 Comprehensive examples

The examples in this section illustrate applying the simplified guidance available for current accounts receivable and current contract assets.

- Subtopic 326-20's Example 5A, which illustrates:
  - Case 1: Election of Practical Expedient
  - Case 2: Application of Practical Expedient When Receivable Does Not Share Similar Characteristics
  - Case 3: Practical Expedient Accompanied by Accounting Policy Election – Entity R Selects March 1 as Evaluation Date for Subsequent Collection Activity

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

  - — Case 4: Practical Expedient Accompanied by Accounting Policy Election – Entity R Selects May 31 as Evaluation Date for Subsequent Collection Activity

- KPMG Example 10.4.10, which illustrates the effect of applying the simplified guidance.

## Excerpt from ASC 326-20

• > Example 5A: Practical Expedient and Accounting Policy Election for Estimating Expected Credit Losses on Current Accounts Receivable and Current Contract Assets

**55-40A** This Example illustrates how to apply the practical expedient and accounting policy election for estimating credit losses on current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 on revenue from **contracts** with **customers** in accordance with paragraphs 326-20-30-10A through 30-10H. The accounting policy election to consider subsequent collection activity described in paragraphs 326-20-30-10E through 30-10H is applicable only to entities other than **public business entities**. Assume that Entity R is not a public business entity and does not have any contract assets.

**55-40B** Entity R manufactures and sells products to a broad range of customers that are primarily retail stores. Entity R provides customers with payment terms of 30 days. Entity R recognizes revenue and corresponding accounts receivable related to the sale of products in accordance with Topic 606 (referred to as "receivable(s)" in the remainder of this Example). Entity R monitors payment activity and, for purposes of estimating expected credit losses, classifies outstanding receivables on the basis of the number of days past due (delinquency) when a receivable has not been collected in accordance with the payment terms. Delinquent receivables are assessed to determine whether they continue to share similar risk characteristics with other receivables in the portfolio. Entity R uses its historical collection information to calculate a credit loss rate for each portfolio segment of receivables.

**55-40C** On December 31, 20X0, the outstanding balance and historical credit loss rates for each portfolio segment of Entity R's receivables are as follows.

| Past-Due Status | Outstanding Receivables Balance | Credit Loss Rate |
|---|---|---|
| Current | $ 5,984,698 | 0.3% |
| 1–30 days past due | 8,272 | 8% |
| 31–60 days past due | 2,882 | 26% |
| 61–90 days past due | 841 | 58% |
| 91–120 days past due | 554 | 82% |
| More than 120 days past due | 342 | 99% |
| Total | $ 5,997,589 | |

**55-40D** Entity R has determined that its historical loss rates are a reasonable basis on which to estimate expected credit losses for outstanding receivables because of the similar risk characteristics of its customers (paragraph 326-20-

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

30-8) and because its payment terms have not changed significantly over time. Management determined that current conditions as of the balance sheet date are consistent with conditions that existed during the period that historical data were collected.

• • > Case 1: Election of Practical Expedient

**55-40E** Entity R elects the practical expedient in paragraphs 326-20- 30-10C through 30-10D to estimate expected credit losses related to its receivables classified as current in accordance with paragraph 210-10-45-3. The practical expedient allows Entity R to assume that current conditions as of the balance sheet date do not change for the remaining life of the assets. Entity R has determined that the current conditions as of the balance sheet date are consistent with those conditions that existed during the period that the historical data were collected. Accordingly, Entity R determines that no adjustment to its historical loss information is necessary. Entity R develops its estimate of expected credit losses as follows.

| Past-Due Status | Outstanding Receivables Balance | Credit Loss Rate | Expected Credit Loss Estimate |
|---|---|---|---|
| Current | $ 5,984,698 | 0.3% | $ 17,954 |
| 1–30 days past due | 8,272 | 8% | 662 |
| 31–60 days past due | 2,882 | 26% | 749 |
| 61–90 days past due | 841 | 58% | 488 |
| 91–120 days past due | 554 | 82% | 454 |
| More than 120 days past due | 342 | 99% | 339 |
| Total | $ 5,997,589 | | $ 20,646 |

**55-40F** Entity R discloses that it has elected the practical expedient to assume that current conditions as of the balance sheet date do not change for the remaining life of the assets in accordance with the requirement in paragraph 326-20-50-12A.

• • > Case 2: Application of Practical Expedient When Receivable Does Not Share Similar Characteristics

**55-40G** Assume the same facts and circumstances as Case 1, except that Entity R has an outstanding receivable balance of $2,000 aged 30-days past due at the balance sheet date from Customer S, who filed for bankruptcy on December 15, 20X0. The entirety of the balance is not expected to be collected. As a result, Entity R determines that the receivable due from Customer S no longer shares similar risk characteristics with receivables due from other customers. Therefore, Entity R measures expected credit losses from Customer S individually.

**55-40H** Entity R has not identified other information that is expected to affect the collectibility of the remaining portfolio of receivables and estimates expected credit losses on the remaining portfolio collectively using the practical expedient. Entity R develops its estimate of expected credit losses as follows.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Past-Due Status | Outstanding Receivables Balance | Credit Loss Rate | Expected Credit Loss Estimate |
|---|---|---|---|
| Current | $ 5,984,698 | 0.3% | $ 17,954 |
| 1–30 days past due | 6,272 [(a)] | 8% | 502 |
| 31–60 days past due | 2,882 | 26% | 749 |
| 61–90 days past due | 841 | 58% | 488 |
| 91–120 days past due | 554 | 82% | 454 |
| More than 120 days past due | 342 | 99% | 339 |
| Collectively assessed subtotal | 5,995,589 | | 20,486 |
| Individually assessed subtotal (Customer S) | 2,000 | | 2,000 |
| Total | $ 5,997,589 | | $ 22,486 |

(a) Outstanding receivable balance reduced by $2,000 to reflect individual assessment of Customer S.

**55-40I** Entity R discloses that it has elected the practical expedient to assume that current conditions as of the balance sheet date do not change for the remaining life of the assets in accordance with the requirement in paragraph 326-20-50-12A.

• • > Case 3: Practical Expedient Accompanied by Accounting Policy Election — Entity R Selects March 1 as Evaluation Date for Subsequent Collection Activity

**55-40J** Assume the same facts and circumstances as Case 1, except that Entity R also elects to consider collection activity after the balance sheet date when estimating expected credit losses (that is, it elects to apply the accounting policy election in paragraphs 326-20-30-10E through 30-10H). Entity R considers collection activity through March 1, 20X1, which is the date that the **financial statements are available to be issued**.

**55-40K** Entity R has not identified other information that is expected to affect the collectibility of its receivables other than the collection activity detailed in paragraph 326-20-55-40L. Entity R has not updated its historical credit loss rates for collection activity after the balance sheet date.

**55-40L** Entity R's December 31, 20X0 financial statements are available to be issued on March 1, 20X1. Entity R has observed the following subsequent collection activity for all outstanding receivables as of the balance sheet date (December 31, 20X0).

| Balance Sheet Date 12/31/20X0 | | Collections between Balance Sheet Date and 3/1/20X1 | Date The Entity Has Selected To Consider Subsequent Collection Activity 3/1/20X1 | | | |
|---|---|---|---|---|---|---|
| Past-Due Status | Outstanding Receivables Balance | | Remaining Balance Uncollected | Past-Due Status | Credit Loss Rate[a] | Expected Credit Loss Estimate |
| Current | $ 5,984,698 | $ (5,925,118) | $ 59,580 | 31–60 days past due | 26% | $ 15,491 |
| 1–30 days past due | 6,272 | (1,776) | 4,496 | 61–90 days past due | 58% | 2,866 |
| 31–60 days past due | 2,882 | (441) | 2,441 | 91–120 days past due | 82% | 2,002 |
| 61–90 days past due | 841 | (300) | 541 | More than 120 days past due | 99% | 536 |
| 91–120 days past due | 554 | (149) | 405 | More than 120 days past due | 99% | 401 |
| More than 120 days past due | 342 | (43) | 299 | More than 120 days past due | 99% | 296 |
| Total | $ 5,997,589 | $ (5,929,727) | $ 67,862 | | | $ 21,592 |

(a) Credit loss rate based on the collection status as of the date the entity has selected to consider subsequent collection activity.

Entity R develops its estimate of expected credit losses by determining which receivables have been collected between the balance sheet date and the date that the entity has selected to consider subsequent collection activity (in this Case, March 1, 20X1) and by recognizing an allowance for the amounts that are uncollected based on its historical loss rates as of the balance sheet date that correspond to the uncollected balance's delinquency status as of the date the entity has selected to consider subsequent collection activity (in this Case, March 1, 20X1).

**55-40M** Entity R discloses that it has elected the practical expedient to assume that current conditions as of the balance sheet date do not change for the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

remaining life of the assets and the accounting policy election to consider subsequent collection activity, along with the date through which collection activity was considered (in this Case, March 1, 20X1), in accordance with the requirements in paragraphs 326-20-50-12A through 50-12B.

• • > Case 4: Practical Expedient Accompanied by Accounting Policy Election — Entity R Selects May 31 as Evaluation Date for Subsequent Collection Activity

**55-40N** Assume the same facts and circumstances as Case 1, except that Entity R also elects to consider collection activity after the balance sheet date when estimating expected credit losses (that is, it elects to apply the accounting policy election in paragraphs 326-20-30-10E through 30-10H). Entity R considers subsequent collection activity through May 31, 20X1.

**55-40O** Entity R has not identified other information that is expected to affect the collectibility of its receivables other than the collection activity detailed in paragraph 326-20-55-40P. Entity R has not updated its historical credit loss rates for collection activity after the balance sheet date.

**55-40P** Entity R's December 31, 20X0 financial statements are available to be issued on June 15, 20X1. As of May 31, 20X1, Entity R has observed the following collection activity for outstanding receivables as of the balance sheet date (December 31, 20X0).

| Balance Sheet Date | | | Date The Entity Has Selected To Consider Subsequent Collection Activity | | | |
|---|---|---|---|---|---|---|
| 12/31/20X0 | | | 5/31/20X1 | | | |
| Past-Due Status | Outstanding Receivables Balance | Collections between Balance Sheet Date and 5/31/20X1 | Remaining Balance Uncollected | Past-Due Status | Credit Loss Rate[a] | Expected Credit Loss Estimate |
| Current | $ 9,384,568 | $ (5,968,449) | $ 16,249 | More than 120 days past due | 99% | $ 16,087 |
| 1–30 days past due | 8,272 | (8,272) | – | More than 120 days past due | 99% | – |
| 31–60 days past due | 2,882 | (2,279) | 603 | More than 120 days past due | 99% | 597 |
| 61–90 days past due | 841 | (623) | 218 | More than 120 days past due | 99% | 216 |
| 91–120 days past due | 554 | (289) | 265 | More than 120 days past due | 99% | 262 |
| More than 120 days past due | 342 | (145) | 197 | More than 120 days past due | 99% | 195 |
| Total | $ 9,397,569 | $ (5,980,057) | $ 17,532 | | | $ 17,357 |

(a) Credit loss rate based on the collection status as of the date the entity has selected to consider subsequent collection activity.

As part of the estimate of expected credit losses, Entity R applies a credit loss rate of 99 percent to the receivables that are uncollected as of the date through which it considers subsequent collection activity (in this Case, May 31, 20X1) because all remaining amounts have been outstanding for more than 120 days.

**55-40Q** Entity R discloses that it has elected the practical expedient to assume that current conditions as of the balance sheet date do not change for the remaining life of the assets and the accounting policy election to consider subsequent collection activity, along with the date through which collection activity was considered (in this Case, May 31, 20X1), in accordance with the requirements in paragraphs 326-20-50-12A through 50-12B.

## **Example 10.4.10** Effect of applying the simplifications

As of December 31, Year 1, ABC Corp., a nonpublic entity, has an outstanding balance of $200,000 in current accounts receivable arising from transactions accounted for under Topic 606. The receivables are 25 days past due and have a historical loss rate of 7%. ABC uses an aging schedule to estimate expected credit losses. Its process for developing loss rates using an aging schedule is consistent with guidance on developing historical loss experience in chapter 7.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC determines that current and reasonable and supportable forecasted economic conditions have deteriorated as compared with the economic conditions included in the historical loss information. It estimates the loss rate will increase by a total of 3%, consisting of:

- 1% due to changes in current economic conditions as of the balance sheet date as compared to those in historical period(s) used for obtaining historical loss experience; and
- 2% for reasonable and supportable forecasts of future economic conditions.

By March 15, Year 2 – the date the financial statements are available to be issued – $190,000 of the current accounts receivable are collected and $10,000 remains uncollected. The delinquency status of the $10,000 uncollected receivables on March 15, Year 2 is over 90 days past due. The historical loss rate for accounts over 90 days past due is 74%. That loss rate (i.e. 74%) does not reflect adjustments for the deterioration in current economic conditions as of the balance sheet date or reasonable and supportable forecasts of economic conditions.

ABC elects both the practical expedient and accounting policy election to simplify its estimation of expected credit losses for current accounts receivable. ABC designates March 15, Year 2 – the date financial statements are available to be issued – as the date through which subsequent collection activity is considered in estimating expected credit losses. Because it uses an aging schedule, ABC is permitted to make an accounting policy election to update its historical loss rates based on subsequent collections. However, ABC does not elect to update the historical loss rate for subsequent collection activity.

The following table compares measurement of the allowance for credit losses as of December 31, Year 1 with – and without – the simplifications.

| Allowance for credit losses without the simplifications | Allowance for credit losses with the simplifications |
|---|---|
| 200,000[1] × 10%[2] = 20,000 | 10,000[3] × 75%[4] = 7,500 |

Notes:

1. The full outstanding accounts receivable balance as of the balance sheet date.
2. The total adjusted loss rate of 10% = 7% (historical loss rate for receivables 25 days past due) + 1% (adjustment for deterioration in current economic conditions) + 2% (adjustment for deterioration in reasonable and supportable forecasted economic conditions).
3. The remaining uncollected portion of the receivable balance ($200,000[1] – $190,000 collected by March 15, Year 2).
4. The adjusted loss rate of 75% = 74% (historical loss rate for receivables over 90 days past due) + 1% (adjustment for deterioration in current economic conditions).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 12. Purchased financial assets

## Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

**12.1 How the standard works#**

**12.2 Scope**

12.2.10 PCD assets#

12.2.20 Purchased seasoned loans (PSLs)**

**Questions**

**Question 12.2.10** When has an acquired financial asset experienced a more-than-insignificant deterioration in credit quality since origination or issuance?

**Question 12.2.12** What does an entity evaluate to determine whether PCD accounting should be applied to an HTM debt security?

**Question 12.2.13** What changes in a financial asset's credit quality does an entity evaluate to determine whether PCD accounting should be applied?

**Question 12.2.15** Does an entity apply PCD accounting to net investments in leases with more-than-insignificant credit deterioration at the date of acquisition?

**Question 12.2.17** What does an entity evaluate to determine whether PCD accounting should be applied to a net investment in a lease?

**Question 12.2.20** Does an entity apply the PCD definition at the individual asset or portfolio level?

**Question 12.2.25** Subsequent to acquisition, can assets acquired in the same fiscal quarter be pooled when estimating expected credit losses?

**Question 12.2.30** Can a financial asset recognized at a premium be a PCD asset?

**Question 12.2.40** May an entity apply the accounting for PCD assets at the time a loan is transferred from held-for-sale to held-for-investment?

**Question 12.2.50** Does the transferee (buyer) need to evaluate whether a transfer of financial assets meets the requirements for sale accounting when determining whether PCD accounting should be applied?

**Question 12.2.60** [Not used]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 12.2.70** Does a seller apply PCD accounting when it re-recognizes a previously sold financial asset that has experienced a more-than-insignificant credit deterioration?

**Question 12.2.80** When is an acquired loan considered a 'purchased seasoned loan'?

**Question 12.2.90** Are all financial assets subject to the PSL guidance?

**Question 12.2.100** Are all revolving loans excluded from the PSL guidance?

**Question 12.2.110** [Not used]

**Question 12.2.120** How does an acquirer/purchaser determine whether it was 'involved' with a loan's origination?

**Question 12.2.130** Does an entity determine whether it was involved with the origination of a loan at the individual asset or portfolio level?

**Question 12.2.140** Does the acquirer/purchaser need to evaluate whether a transfer of financial assets meets the requirements for sale accounting when determining whether PSL accounting applies?

**Question 12.2.150** May an entity apply the accounting for PSLs at the time a loan is transferred from held-for-sale to held-for-investment?

**Question 12.2.160** Are net investments in leases subject to the PSL guidance?

**Example**

**Example 12.2.10** Transfer accounted for as a secured borrowing

## 12.3 Initial measurement of expected credit losses

12.3.10 Overview#

12.3.20 Valuation methods

**Questions**

**Question 12.3.10** What is the effect of using the gross-up method for PCD assets and PSLs?#

**Question 12.3.20** [Not used]

**Question 12.3.30** [Not used]

**Question 12.3.35** How does an acquirer/purchaser account for financial assets previously written off by the acquiree/seller?

**Question 12.3.37** How is the gross-up and immediate writeoff of a PCD asset included in the roll-forward of the allowance for credit losses?

**Question 12.3.40** May the initial estimate of the allowance for credit losses for PCD assets and PSLs vary based on the method used?#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 12.3.50** How does an entity initially estimate expected credit losses for PCD assets and PSLs if a discounted cash flow method is not used?#

**Examples**

**Example 12.3.10** Initial measurement of PCD assets

**Example 12.3.12** Initial measurement of PCD assets acquired at a premium

**Example 12.3.20** [Not used]

**Example 12.3.30** Initial measurement of PCD assets using a discounted cash flow method

**Example 12.3.40** Initial measurement of PCD assets using a non-discounted cash flow method

**12.4 Subsequent measurement of expected credit losses**

12.4.10 Overview#

12.4.20 Expected recoveries of PCD assets#

12.4.30 FASB examples of expected recoveries

**Questions**

**Question 12.4.10** For PCD assets and PSLs, does an entity have to maintain the method used to initially estimate expected credit losses for subsequent measurement?**

**Question 12.4.20** Must an entity maintain the integrity of a pool of PCD assets or PSLs?#

**Question 12.4.30** When using a method other than a discounted cash flow method, how does an entity ensure expected recoveries on PCD assets do not accelerate recognition of the non-credit discount?

**Examples**

**Example 12.4.10** Subsequent measurement of PCD assets using a discounted cash flow method

**Example 12.4.20** Subsequent measurement of PCD assets using a non-discounted cash flow method

**Example 12.4.30** Recognizing expected recoveries of PCD assets when a method other than a discounted cash flow method is used to estimate credit losses

**12.5 Interest income recognition**

12.5.10 Overview#

**Questions**

**Question 12.5.10** Does an entity recognize the non-credit discount for PCD assets and PSLs at a pool level?#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 12.5.20** May a PCD asset or PSL be placed on nonaccrual status?#

## 12.6 Accounting for legacy GAAP pools of PCI assets maintained at transition

### Question

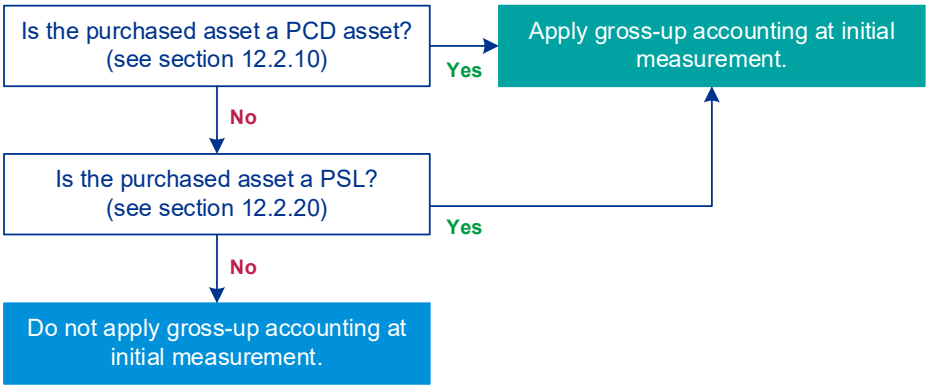
**Question 12.6.10** How does accounting for PCD assets differ when an entity elected to maintain legacy GAAP pools of loans?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 12.1 How the standard works#

*This chapter is written as if ASU 2025-08, which introduced the concept of purchased seasoned loans (PSLs), is fully effective. Because the ASU introduces significant and pervasive changes to the accounting for acquired financial assets, readers should be aware that certain requirements described here may not yet be effective for entities that have not elected early adoption of the ASU. See section 25.3 for transition and effective dates guidance for ASU 2025-08.*

Subtopic 326-20 provides different initial measurement guidance – as well as certain differences in subsequent measurement guidance – for a purchased financial asset that is either a purchase credit deteriorated (PCD) asset (see section 12.2.10) or is a purchased seasoned loan (PSL) (see section 12.2.20). The following diagram summarizes the decisions for determining whether a purchased financial asset is accounted for under the PCD or PSL guidance.




An entity records PCD assets and PSLs at the purchase price plus the allowance for credit losses (expected credit losses) at the time of acquisition, which is referred to as 'gross-up' accounting.

Under this method, there is no credit loss expense affecting net income on acquisition. Changes in estimates of expected credit losses after acquisition of PCD assets and PSLs are recognized as credit loss expense (or reversal of credit loss expense) in subsequent periods as they arise.

Subtopic 326-20 provides some specific guidance for estimating expected credit losses and recognizing interest income for these acquired assets, which is summarized in the following table.

| Topic | PCD assets guidance | PSLs guidance |
|---|---|---|
| **Estimating expected credit losses when not using a discounted cash flow method**<br>See sections 12.3.10 and 12.4.10. | Required to be measured based on the unpaid principal balance, both initially and subsequently. | Required to be initially measured based on the unpaid principal balance.<br>Policy election to measure after acquisition based on either the amortized cost basis or unpaid principal balance. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Topic | PCD assets guidance | PSLs guidance |
|---|---|---|
| **Estimated expected recoveries** | Specific guidance is provided that limits the extent to which expected recoveries are recognized for PCD assets (i.e. a 'recovery cap').<br>See section 12.4.20. | No specific guidance applies. |
| **Interest income recognition** | Specific guidance is provided that requires a reasonable expectation of amounts to be collected before recognizing interest income for PCD assets.<br>See section 12.5.10. | No specific guidance applies. |

In this chapter:

- sections 12.2 to 12.5 discuss identifying and accounting for PCD assets and PSLs under Subtopic 326-20, and apply to assets that are acquired after adoption of Topic 326 or to an entity that elected not to maintain previously existing pools on adoption of Topic 326; and
- section 12.6 discusses accounting by an entity that elected to maintain previously existing pools on adoption of Topic 326 for PCD assets.

For PCD assets that are beneficial interests in the scope of Subtopic 325-40, see chapter 20; and for PCD assets that are AFS securities in the scope of Subtopic 326-30, see chapter 19.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 12.2 Scope

## 12.2.10 PCD assets#

### Excerpt from ASC 326-20

**20 Glossary**

**Purchased Financial Assets with Credit Deterioration**

Acquired individual **financial assets** (or acquired groups of financial assets with similar risk characteristics) that as of the date of acquisition have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment. See paragraph 326-20-55-5 for more information on the meaning of similar risk characteristics for assets measured on an amortized cost basis.

When acquiring financial assets that are in the scope of Subtopic 326-20, an entity first determines whether they are PCD assets. Financial assets in the scope of Subtopic 326-20 that can be identified as PCD assets include: [326-20-15-2(a)]

- financing receivables;
- HTM debt securities;
- receivables resulting from revenue transactions;
- reinsurance recoverables;
- receivables relating to repurchase agreements and securities lending agreements; and
- net investments in leases.

For additional discussion of the scope of Subtopic 326-20, including the types of assets excluded from its scope, see chapter 2.

An asset in the scope of Subtopic 326-20 is a PCD asset if, on the acquisition date, it has experienced a more-than-insignificant deterioration in credit quality since origination or issuance. A single asset can be deemed a PCD asset, or a group of assets acquired together that have similar risk characteristics can be deemed PCD assets. [326-20 Glossary]

### **Question 12.2.10** When has an acquired financial asset experienced a more-than-insignificant deterioration in credit quality since origination or issuance?

**Interpretive response:** PCD accounting applies to acquired individual financial assets – or acquired groups of financial assets with similar risk characteristics – that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination or issuance, as determined by an acquirer's assessment.

The FASB did not define the term 'more-than-insignificant deterioration in credit quality'. It stated that it did not intend for PCD accounting to be limited to

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

financial assets that would have been considered nonaccrual or impaired under legacy US GAAP; instead, it intended the term to also include additional assets that have experienced a more-than-insignificant level of credit deterioration since origination. [ASU 2016-13.BC90]

However, the FASB decided not to extend PCD accounting to purchased assets when there is an insignificant increase in credit risk since origination or issuance. This is because: [ASU 2016-13.BC88]

- the credit risk may be difficult to reliably isolate from other discounts reflected in the purchase price when it is insignificant;
- the cost of separating the credit and non-credit discount may outweigh the benefits; and
- the accretion of the credit discount into income would be insignificant.

Without a definition of 'more-than-insignificant deterioration in credit quality', judgment is required to determine which assets meet this condition.

Specifically, the evaluation of whether the acquired assets meet the PCD definition is based on the acquirer's assessment at the time of acquisition and is a relative comparison of:

- the credit quality of the assets at the time the assets were originated or issued; to
- the credit quality of the assets at the time of acquisition.

The assessment may be operationally challenging for the acquirer because it requires an assessment of the credit quality of the asset at the date of origination or issuance even though the acquirer was not a party to the asset.

## **Question 12.2.12** What does an entity evaluate to determine whether PCD accounting should be applied to an HTM debt security?

**Interpretive response:** When an entity acquires an HTM debt security, we believe the entity should determine whether, as of the date of acquisition, the security has experienced a more-than-insignificant deterioration in credit quality since it was originally issued.

Although the definition of PCD specifically refers to origination, and not issuance, we believe the date of issuance for a debt security is effectively the same as the date of origination.

## **Question 12.2.13** What changes in a financial asset's credit quality does an entity evaluate to determine whether PCD accounting should be applied?

**Interpretive response:** We believe an entity should consider changes in all aspects of a financial asset's credit quality since origination. This includes the borrower's ability to repay and collateral values, if applicable. We believe there

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

may be scenarios in which PCD accounting should be applied solely because of declines in the collateral value since origination.

## **Question 12.2.15** Does an entity apply PCD accounting to net investments in leases with more-than-insignificant credit deterioration at the date of acquisition?

**Interpretive response:** Yes. We believe an entity should apply PCD accounting to all assets in the scope of Subtopic 326-20 that have experienced a more-than-insignificant deterioration in credit quality since origination. Topic 326 and the basis for conclusions do not indicate that net investments in leases are excluded from the scope of PCD accounting.

## **Question 12.2.17** What does an entity evaluate to determine whether PCD accounting should be applied to a net investment in a lease?

**Background:** A net investment in a lease includes the following: [842-30-25-1, 25-3 – 25-8, 30-1 – 30-2, 40-1]

- for sales-type leases, the lease receivable and an unguaranteed residual asset; and
- for direct financing leases, the lease receivable and an unguaranteed residual asset; however, the net investment is reduced by any deferred selling profit.

A lessor assesses the entire net investment in the lease (i.e. including the unguaranteed residual asset) for impairment and recognizes any impairment loss under Subtopic 326-20.

**Interpretive response:** The FASB decided that the net investment in a sales-type or direct financing lease should be treated as a single unit of account for purposes of assessing impairment and recording a loss allowance. Similarly, the entire net investment is evaluated as a single unit of account when determining if PCD accounting should be applied.

Therefore, when an entity acquires a net investment in a lease and evaluates whether PCD accounting should be applied, we believe the entity should consider changes since origination in both the credit risk of the lease receivable and the estimated residual value of the leased asset. This means an entity should evaluate both increases in credit risk and declines in the estimated residual value since origination.

We believe there may be scenarios in which PCD accounting should be applied solely because of declines in the residual value since origination. For example, as part of a business combination, an entity may acquire a net investment in a lease in which the change in the estimated residual value of the leased asset caused a more than insignificant decline in the overall credit risk.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12.2.20** Does an entity apply the PCD definition at the individual asset or portfolio level?

**Interpretive response:** An entity may evaluate whether purchased assets meet the definition of PCD assets either at the individual asset level or at the portfolio level. However, if the evaluation is done at the portfolio level, the assets in the portfolio need to have similar risk characteristics. For further discussion of similar risk characteristics, see section 5.2.

Subtopic 326-20 is not explicit on whether all of the individual assets in the portfolio need to have a more-than-insignificant deterioration in credit quality. The FASB acknowledged that it chose to permit a portfolio-level assessment because it was unrealistic to expect that an entity would be able to individually evaluate each asset in a portfolio to determine if the asset had a more-than-insignificant deterioration in credit quality since origination or issuance. [ASU 2016-13.BC89]

Therefore, when a portfolio-level assessment is performed, an entity is not required to demonstrate that each individual asset in the portfolio has a more-than-insignificant deterioration in credit quality since origination or issuance. However, it is equally evident that the FASB did not intend for the guidance on PCD assets to be applied to purchased financial assets that do not have a more-than-insignificant deterioration in credit quality since origination or issuance. As a result, we believe the portfolio-level assessment should not be applied at such a high level that the asset grouping would reasonably be expected to include individual assets that do not have any credit deterioration or have an insignificant credit deterioration since origination or issuance.

## **Question 12.2.25** Subsequent to acquisition, can assets acquired in the same fiscal quarter be pooled when estimating expected credit losses?

**Interpretive response:** Pooling financial assets acquired in the same fiscal quarter is permitted under Subtopic 326-20 only when the financial assets share similar risk characteristics with each other. In addition, the acquired financial assets should be pooled with other financial assets already held by an entity if they share similar risk characteristics.

However, to make the provisions of Subtopic 326-20 operational, an entity may consider pooling assets at a more granular level – e.g. first by similar risk characteristics and then by a non-risk-based characteristic such as quarter of acquisition. To do that, the entity needs to demonstrate (either qualitatively or quantitatively) that the estimate of expected credit losses based on the more granular, non-risk-based, level of pooling would yield similar results to the higher level of aggregation required by Subtopic 326-20. For further discussion of collective assessments, see section 5.2.

An entity should monitor the risk characteristics of the financial assets in a pool and adjust the pool on an ongoing basis as the risk characteristics of the individual financial assets change over time.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Further, an entity needs to choose which risk characteristics to apply under Subtopic 326-20 for the purpose of aggregating financial assets into pools. As discussed in Question 5.2.10, although Subtopic 326-20 does not specifically require an entity to consider a financial asset's primary credit quality indicator when aggregating financial assets, we generally expect an entity to factor in some credit-related characteristics. Because Subtopic 326-20 includes some of the same risk characteristics as Subtopic 310-30, an entity could continue to use the same risk characteristics under Subtopic 326-20. However, it could also choose to consider different risk characteristics when pooling under Subtopic 326-20.

## **Question 12.2.30** Can a financial asset recognized at a premium be a PCD asset?

**Interpretive response:** Yes. An entity is required to gross up the amortized cost basis of a PCD asset for the initial estimate of credit losses (see section 12.3.10); this guidance does not distinguish between financial assets purchased at a premium or discount. Therefore, we believe that a financial asset purchased at a premium can be a PCD asset. [326-20-30-13]

PCD assets are generally purchased at a discount because of credit deterioration. However, there are less frequent situations in which non-credit factors (e.g. a declining interest rate environment) result in a financial asset being purchased at a premium even when it has experienced a more-than-insignificant deterioration in credit quality since origination or issuance.

Similarly, there also are situations in which a financial asset is purchased at a small discount to par or the principal amount, but is initially recognized at a premium because of the PCD gross-up of the amortized cost basis for the initial estimate of credit losses. This occurs when the initial estimate of credit losses exceeds the purchase price discount.

## **Question 12.2.40** May an entity apply the accounting for PCD assets at the time a loan is transferred from held-for-sale to held-for-investment?

**Interpretive response:** No. PCD accounting only applies at the date of acquisition and should not be applied at the time of a transfer of a loan from the held-for-sale category to the held-for-investment category.

When a loan is classified as held-for-sale at origination/purchase, it is not in the scope of Subtopic 326-20. Instead, it is accounted for at the lower of cost or fair value under either Subtopic 310-10 (nonmortgage loans) or Topic 948 (mortgage loans). When the loan is reclassified as held-for-investment, it is accounted for under Subtopic 326-20 similar to any originated loan even if it experienced a more-than-insignificant deterioration in credit quality before the transfer. [310-10-35-48, 948-310-35-1]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12.2.50** Does the transferee (buyer) need to evaluate whether a transfer of financial assets meets the requirements for sale accounting when determining whether PCD accounting should be applied?

**Interpretive response:** Yes. We believe that PCD accounting is appropriate only when the transferee (buyer) has determined that the transfer meets the requirements for sale accounting. Unless the requirements for sale accounting are met, the transferee records a newly originated financial asset due from the transferor (seller), as opposed to recording a purchase of the underlying credit deteriorated financial asset that was transferred.

This view is consistent with views expressed by the SEC staff. [2017 AICPA Conf]

## **Example 12.2.10** Transfer accounted for as a secured borrowing

Retailer originates installment loans when it sells goods to its customers. Retailer later transfers those installment loans to Finance Co. That transfer does not meet the sale accounting criteria of Topic 860 and therefore is accounted for as a secured borrowing.

Finance Co. should not consider its loan receivable from Retailer to be a PCD asset, even if the underlying consumer loans have experienced a more-than-insignificant deterioration in credit quality since they were originated by Retailer. This is because Finance Co. accounts for the transfer as a newly originated loan receivable from Retailer rather than as a purchase of the underlying consumer loan receivables.

## **Question 12.2.70** Does a seller apply PCD accounting when it re-recognizes a previously sold financial asset that has experienced a more-than-insignificant credit deterioration?

**Background:** A seller evaluates Topic 860's derecognition criteria and applies sale accounting if certain criteria are met. These criteria are required to be met not only at the time a financial asset is transferred, but also subsequent to the transfer.

Subsequent analysis is required when the seller initially applies sale accounting because events may occur that result in a seller regaining control of the previously transferred financial asset. For example, this can occur when a seller has a unilateral call option that is contingent on the underlying borrower's default and the underlying borrower subsequently defaults. The seller accounts for such an event as the purchase of a new financial asset. [860-20-25-8 – 25-9]

**Interpretive response:** Yes. The re-recognition of the previously transferred asset is accounted for in the same manner as a purchase (i.e. a new

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

acquisition). Therefore, we believe that PCD accounting should be applied by the seller if the financial asset is in the scope of Topic 326 and has experienced a more-than-insignificant deterioration in credit quality since it was originated.

## 12.2.20 Purchased seasoned loans (PSLs)**

### Excerpt from ASC 326-20

**20 Glossary**

**Loan**

A contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable.

**Purchased Seasoned Loans**

Paragraphs 326-20-30-16 through 30-18 define the term *purchased seasoned loans.*

• > Purchased Seasoned Loans

**30-16** A purchased seasoned loan is a **loan** that meets either of the following criteria and is not a purchased financial asset with credit deterioration or a financial asset listed in paragraph 326-20-30-19:

a. The loan is obtained through a business combination accounted for using the acquisition method in accordance with Subtopic 805-20.
b. The loan is (i) obtained through a transfer that is not a business combination accounted for using the acquisition method in accordance with Subtopic 805-20 or (ii) initially recognized through the consolidation of a variable interest entity in accordance with paragraph 810-10-30-3. In addition, the loan must meet both of the following criteria:
    1. The loan is obtained more than 90 days after its origination date.
    2. The transferee was not involved with the origination of the loan. See paragraph 326-20-30-17 for guidance on how to assess whether the transferee was involved with the origination of the loan.

**30-17** The transferee is more likely to be involved with the origination of a loan when the transfer of that loan is effected through the terms of an existing contractual relationship, financing arrangement, purchase commitment, or other agreement with the entity that originated and transferred the loan. The transferee is involved with the origination of a loan when either of the following occurs:

a. Within 90 days after the loan origination date, the transferee has direct or indirect exposure to the economic risks and rewards of ownership.
b. The transferee has substantive influence on the offering, arranging, underwriting, or other nonadministrative lending activity performed by the originator (the transferor) related to the initial extension of credit to a debtor.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**30-18** When the transferee acquires a group of loans under paragraph 326-20-30-16(b), it shall evaluate the guidance in paragraph 326-20-30-17 on an individual loan basis.

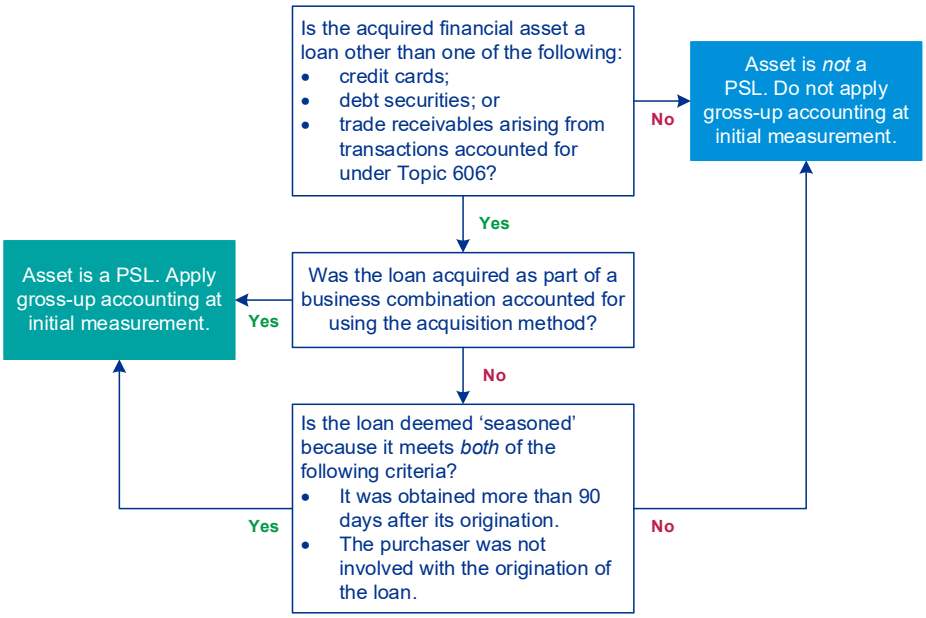
**30-19** Purchased seasoned loans do not include the following:

a. Credit cards
b. **Debt securities**
c. Trade receivables arising from transactions accounted for under Topic 606 on revenue from contracts with customers.

After an entity has determined that an acquired asset is not a PCD asset, it determines whether it is a purchased seasoned loan (PSL).

## **Question 12.2.80** When is an acquired loan considered a 'purchased seasoned loan'?

**Interpretive response:** The following decision tree summarizes the considerations for determining whether an acquired loan that is not PCD (see section 12.2.10) is a PSL.




## **Question 12.2.90** Are all financial assets subject to the PSL guidance?

**Interpretive response:** No. Only loans are subject to the PSL guidance. A loan is defined as a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

(with terms exceeding one year) and notes receivable. Further, none of the following are subject to the PSL guidance: [326-20 Glossary, 326-20-30-16, 30-19]

- PCD assets (see section 12.2.10);
- credit card receivables;
- debt securities; and
- trade receivables arising from transactions accounted for under Topic 606.

See also Question 12.2.160 about net investments in leases.

## **Question 12.2.100** Are all revolving loans excluded from the PSL guidance?

**Interpretive response:** No. Credit card receivables are the only type of revolving loans excluded from the PSL guidance. Therefore, other revolving loans, including consumer lending arrangements such as home equity lines of credit, must be evaluated to determine whether they are PSLs. [326-20-30-19]

## **Question 12.2.120** How does an acquirer/purchaser determine whether it was 'involved' with a loan's origination?

**Interpretive response:** Subtopic 326-20 does not define the term 'involved' but provides guidance for determining whether an acquirer/purchaser was involved with the origination; this guidance is referred to as determining whether a loan is 'seasoned.' Subtopic 326-20 specifies that an acquirer/purchaser is involved when it: [326-20-30-17]

- has direct or indirect exposure to the economic risks and rewards of ownership within 90 days after the loan origination date; or
- has substantive influence on the offering, arranging, underwriting or other nonadministrative lending activity performed by the originator (the transferor) related to the initial extension of credit to a debtor.

Subtopic 326-20 also indicates that those situations are more likely to have occurred when the transfer of the loan is effected through the terms of an existing contractual relationship, financing arrangement, purchase commitment or other agreement with the entity that originated and transferred the loan. Examples of such arrangements include loss-sharing and make-whole arrangements in which the acquirer has an obligation to the originator as a result of a loss of principal incurred by the originator before the transfer of the loan to the acquirer or upon termination of the purchase transaction. [326-20-30-17, ASU 2025-08.BC14]

The purpose of the seasoning guidance is to identify transferred financial assets that are economically similar to financial assets originated by the acquirer on the basis of the substance of the transaction; that is, financial assets that are effectively originated by a third party on behalf of the acquirer. [ASU 2025-08.BC14]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12.2.130** Does an entity determine whether it was involved with the origination of a loan at the individual asset or portfolio level?

**Interpretive response:** A transferee that acquires a group of loans evaluates whether it was involved with origination of a loan at the individual loan level. [326-20-30-18]

## **Question 12.2.140** Does the acquirer/purchaser need to evaluate whether a transfer of financial assets meets the requirements for sale accounting when determining whether PSL accounting applies?

**Interpretive response:** Yes. We believe that PSL accounting is appropriate only when the acquirer/purchaser (transferee) has determined that the transfer meets the requirements for sale accounting. If the requirements for sale accounting are not met, the transferee records a newly originated financial asset due from the transferor (seller), as opposed to recording a purchase of the underlying financial asset that was transferred.

This view is consistent with views expressed by the SEC staff. [2017 AICPA Conf]

## **Question 12.2.150** May an entity apply the accounting for PSLs at the time a loan is transferred from held-for-sale to held-for-investment?

**Interpretive response:** No. PSL accounting only applies at the date of acquisition and cannot be applied at the time of a transfer of a loan from the held-for-sale category to the held-for-investment category.

When a loan is classified as held-for-sale at origination/purchase, it is not in the scope of Subtopic 326-20. Instead, it is accounted for at the lower of cost or fair value under either Subtopic 310-10 (nonmortgage loans) or Topic 948 (mortgage loans). When the loan is reclassified as held-for-investment, it is accounted for under Subtopic 326-20 similar to any originated loan. [310-10-35-48, 948-310-35-1]

## **Question 12.2.160** Are net investments in leases subject to the PSL guidance?

**Interpretive response:** No. As explained in Question 16.2.10, the net investment in a lease includes an unguaranteed residual asset, which does not meet the definition of a financial asset. We believe net investments in leases are not subject to the PSL guidance because an unguaranteed residual asset does not meet the definition of a loan. This is consistent with the FASB's expressed intent to exclude lease receivables. [ASU 2025-08.BC19, BC25]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 12.3 Initial measurement of expected credit losses

## 12.3.10 Overview#

### Excerpt from ASC 326-20

> Purchased Financial Assets with Credit Deterioration and Purchased Seasoned Loans

**30-13** An entity shall record the allowance for credit losses for **purchased financial assets with credit deterioration** and **purchased seasoned loans** in accordance with paragraphs 326-20-30-2 through 30-10, 326-20-30-12, and 326-20-30-14. Additionally, expected recoveries of amounts previously written off and expected to be written off shall be included in determining the allowance for credit losses in accordance with paragraph 326-20-30-1 for purchased seasoned loans and paragraph 326-20-30-13A for purchased financial assets with credit deterioration. An entity shall add the allowance for credit losses at the date of acquisition to the purchase price to determine the initial **amortized cost basis** for purchased financial assets with credit deterioration and purchased seasoned loans. Any noncredit discount or premium resulting from acquiring a pool of purchased financial assets with credit deterioration or purchased seasoned loans shall be allocated to each individual asset. At the acquisition date, the initial allowance for credit losses determined on a collective basis shall be allocated to individual assets to appropriately allocate any noncredit discount or premium.

**30-14** If an entity estimates expected credit losses using a discounted cash flow method for purchased financial assets with credit deterioration and purchased seasoned loans, the entity shall discount expected credit losses at the rate that equates the present value of the purchaser's estimate of the asset's future cash flows with the purchase price of the asset. If an entity estimates expected credit losses using a method other than a discounted cash flow method, the entity shall estimate expected credit losses on the basis of the unpaid principal balance (face value) of the financial asset(s), unless the entity elects the accounting policy election in paragraph 326-20-35-1A for purchased seasoned loans. See paragraphs 326-20-55-66 through 55-78 for implementation guidance and examples.

**30-15** An entity shall account for purchased financial assets that do not have a more-than-insignificant deterioration in credit quality since origination or are not purchased seasoned loans in a manner consistent with originated financial assets in accordance with paragraphs 326-20-30-1 through 30-10 and 326-20-30-12.

PCD and PSL accounting is called 'gross-up accounting' because, at acquisition, an entity grosses up the amortized cost basis of the PCD asset or PSL for the initial estimate of credit losses. This Day 1 allowance for credit losses is established without an income statement effect. [326-20-30-13]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

After the Day 1 allowance is established for a pool of assets, that allowance is then allocated to the individual assets in the pool; this is because the unit of account under Subtopic 326-20 is the individual asset even though measurement of an allowance can occur on a collective basis. Allocating the allowance to the individual assets in a pool establishes the amortized cost basis of each asset. This amortized cost basis is then used to allocate any non-credit premium or discount to the individual assets. However, if an entity elects to maintain previously existing pools on adoption, the pool continues to be the unit of account, and the allowance and non-credit discount or premium is not allocated to the individual assets (see section 12.6). [326-20-30-13]

A purchased financial asset that does not qualify as a PCD asset or a PSL is accounted for similar to an originated financial asset. Generally, this means that an entity recognizes the allowance for credit losses for assets that are not PCD and are also not PSLs through net income on acquisition. Gross-up accounting is not permitted to be applied by analogy to purchased financial assets that do not meet the definition of PCD assets or PSLs. [326-20-30-15]

## **Example 12.3.10** Initial measurement of PCD assets

*Although this example relates to the initial measurement of PCD assets, a similar approach would be appropriate for the initial measurement of PSLs.*

ABC Corp. acquires a portfolio of loans with the intention of holding the loans for investment. It pays $700,000 to the seller for the loans, which have a total par amount (face value) of $1,000,000.

ABC determines that the entire portfolio consists of loans with similar risk characteristics that have experienced a more-than-insignificant deterioration in credit quality since origination. It uses a method other than a discounted cash flow method (e.g. loss-rate method) to estimate the credit losses in the portfolio.

ABC's initial estimates are as follows.

| | |
|---|---|
| Total contractual principal cash flows that it expects to collect: | 800,000 |
| Allowance for credit losses based on unpaid principal balance (par): | 200,000 |
| Non-credit discount: | 100,000 |

ABC records the following journal entry to account for the acquisition of these loans.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Loans | 1,000,000 | |
| Cash | | 700,000 |
| Allowance for credit losses | | 200,000 |
| Loans – non-credit discount | | 100,000 |
| *To record acquisition of PCD loans, estimate of expected credit losses and non-credit discount.* | | |

## **Example 12.3.12** Initial measurement of PCD assets acquired at a premium

*Although this example relates to the initial measurement of PCD assets, a similar approach would be appropriate for the initial measurement of PSLs.*

ABC Corp. acquires a portfolio of fixed-rate mortgage loans that were originated during a period of high interest rates compared to the current environment, paying $15,000,000. The remaining unpaid principal balance is $14,750,000.

ABC determines that the entire portfolio consists of loans with similar risk characteristics that have experienced a more-than-insignificant deterioration in credit quality since origination. It uses a method other than a discounted cash flow method (e.g. loss-rate method) to estimate the credit losses in the portfolio.

ABC's initial estimates are as follows.

| | |
|---|---|
| Total contractual principal cash flows it expects to collect: | 14,000,000 |
| Allowance for credit losses based on the unpaid principal balance (par): | 750,000 |
| Non-credit premium: | 1,000,000 |

ABC records the following journal entry to account for the acquisition of the portfolio of fixed-rate mortgage loans.

| | Debit | Credit |
|---|---|---|
| Loans | 14,750,000 | |
| Loans – non-credit premium[1] | 1,000,000 | |
| Cash | | 15,000,000 |
| Allowance for credit losses[2] | | 750,000 |
| *To record acquisition of PCD loans, estimate of expected credit losses and non-credit premium.* | | |

Notes:

1. The 'loans – non-credit premium' account is part of the loans financial statement caption and has been broken out for illustrative purposes only. The loans – non-credit premium is the difference between the unpaid principal balance

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

($14,750,000) and the amortized cost basis of $15,750,000 (the amount paid ($15,000,000) plus the allowance for credit loss ($750,000)).

2. The allowance for credit losses is the difference between the total remaining unpaid principal balance ($14,750,000) and the total contractual principal cash flows expected to be collected ($14,000,000).

## **Question 12.3.10** What is the effect of using the gross-up method for PCD assets and PSLs?#

**Interpretive response:** The gross-up method results in no Day 1 credit loss recognition in net income for PCD assets and PSLs.

The FASB chose the gross-up method to enhance the comparability of allowance amounts between PCD and non-PCD assets, and to allow preparers to use the same tools and methods for estimating credit losses for all assets in the scope of Subtopic 326-20. The FASB chose the gross-up approach for PSLs to enhance comparability and consistency in the accounting for acquired financial assets. [ASU 2016-13.BC86; ASU 2025-08.BC11]

However, the use of a gross-up method creates a difference in the effect that purchases of PCD assets and PSLs have on the income statement as compared to assets that are not PCD assets or PSLs. When PCD assets and PSLs are purchased, there is no Day 1 credit loss recognition in net income. In contrast, credit losses are recognized in net income on Day 1 for other purchased assets.

## **Question 12.3.35** How does an acquirer/purchaser account for financial assets previously written off by the acquiree/seller?

**Background:** As discussed in Question 12A.2.70, PCD accounting is applied by the acquirer/purchaser to financial assets previously written off by the acquiree/seller if it has the contractual rights to cash flows at the acquisition date.

**Interpretive response:** If the financial assets are deemed PCD, the acquirer/purchaser should:

- recognize the addition of an allowance for credit losses and make a corresponding adjustment to the assets' amortized cost basis;
- apply its writeoff policy and immediately write off the individual PCD assets that are deemed uncollectible under its policy; and
- recognize expected recoveries of amounts previously written off and/or expected to be written off in its allowance for credit losses (see section 12.4.20).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 12.3.37** How is the gross-up and immediate writeoff of a PCD asset included in the roll-forward of the allowance for credit losses?

**Background**: As discussed in Question 12.3.35, an acquirer/purchaser:

- recognizes the addition of an allowance for credit losses and a corresponding adjustment to the PCD asset's amortized cost basis if the asset was previously written off (either in whole in or part) by the acquiree/seller; and
- if the PCD asset's amortized cost, or a portion of its amortized cost, is deemed uncollectible, immediately writes off the PCD asset and the corresponding allowance for credit losses.

**Interpretive response:** Subtopic 326-20 does not prescribe how an entity should disclose the addition of an allowance for credit losses and immediate writeoff of that amount in the allowance roll-forward. To provide meaningful information to financial statement users, we believe it is important to distinguish writeoffs that were recorded at the date of acquisition/purchase of PCD assets from the entity's other writeoffs.

We believe that one of the following approaches, consistently applied, is acceptable.

- Include the writeoffs of PCD assets at the date of acquisition/purchase together with the amounts for other financial assets in the roll-forward of the allowance for credit losses. Include a note after the roll-forward indicating the amount of writeoffs of PCD assets that were recognized at the date of acquisition/purchase.
- Present writeoffs of PCD assets at the date of acquisition/purchase as a separate line item in the roll-forward of the allowance for credit losses.
- Exclude both the addition of the allowance and related writeoff from the roll-forward of the allowance for credit losses. Include a note after the roll-forward indicating the amount of allowance that was added and immediately written off.

## 12.3.20 Valuation methods

Similar to estimating the allowance for credit losses for non-PCD assets, Subtopic 326-20 provides an entity with flexibility on the method used to estimate the Day 1 allowance for credit losses for PCD assets and PSLs. An entity is required to estimate the Day 1 allowance for credit losses under paragraphs 326-20-30-2 to 30-12, which permit the use of a variety of methods as discussed in section 4.2.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12.3.40** May the initial estimate of the allowance for credit losses for PCD assets and PSLs vary based on the method used?#

**Interpretive response:** Yes. Subtopic 326-20 gives flexibility on the method that an entity may use to estimate expected credit losses. Generally, an entity may use a discounted cash flow method or other methods that do not project and discount cash flows – e.g. a loss rate applied to the unpaid principal balance. Different methods may produce differing results. [326-20-30-3, 30-13 – 30-14]

For PCD assets and PSLs, differences in amounts calculated using different methods will lead to differences in the split between the credit discount (recognized as the Day 1 allowance) and the non-credit discount/premium (recognized subsequently as part of interest income). This difference will affect the timing of interest income recognition.

## **Question 12.3.50** How does an entity initially estimate expected credit losses for PCD assets and PSLs if a discounted cash flow method is not used?#

**Interpretive response:** If a discounted cash flow method is not used, the allowance for expected credit losses on PCD assets and PSLs is initially estimated on the basis of the unpaid principal balance of the asset(s). [326-20-30-14]

In contrast, for originated assets or acquired assets that are not PCD or PSL, Subtopic 326-20 requires the allowance for credit losses to be initially estimated on the basis of the amortized cost of the assets when a discounted cash flow method is not used. [326-20-30-5]

The FASB decided that it could not use the same approach for PCD assets because it would give rise to a circularity issue. In earlier deliberations, the FASB had defined the initial amortized cost basis for PCD assets as the sum of the purchase price and the allowance for credit losses. Because the amortized cost for PCD assets includes the allowance for credit losses, the amortized cost basis could not in turn be used in estimating the allowance. Consequently, the FASB decided that when discounted cash flows are not used, the allowance for credit losses on PCD assets should be estimated using the amount of the unpaid principal balance of the asset(s) that is not expected to be collected. The FASB decided the same approach should be used for initially estimating the allowance for credit losses for PSLs.

Although expected credit losses are initially measured based on the unpaid principal balance for PCD assets and PSLs when a method other than a discounted cash flow method is used, an entity can subsequently measure expected credit losses based on the amortized cost of PSLs rather than on the unpaid principal balance. This amortized cost method is limited to PSLs and does not apply to PCD assets (see Question 12.4.10). Additional guidance about subsequent measurement is in section 12.4.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 12.3.30** Initial measurement of PCD assets using a discounted cash flow method

*Although this example relates to PCD assets, a similar approach would be appropriate for initial measurement of PSLs.*

ABC Corp. acquires a portfolio of loans for $600,000 that have the following characteristics.

| | |
|---|---|
| Term: | Five years |
| Amortizable? | Yes |
| Prepayable? | No |
| Initial par amount: | 1,000,000 |
| Coupon: | 5% |
| Annual payments: | 230,975 |

ABC acquires these loans at the end of Year 1 of their five-year life. ABC determines that the loans all share similar risk characteristics and have experienced a more-than-insignificant deterioration in credit quality at the time of acquisition compared to their origination date. Therefore, ABC concludes that it will account for the loans under the guidance for PCD assets.

ABC does not pay or receive any fees or incur any transaction costs associated with this acquisition.

The amortization table based on contractual cash flows at the origination date is as follows.

| Year | Beginning balance | Payments | Interest | Principal | Ending balance |
|---|---|---|---|---|---|
| 1 | 1,000,000 | 230,975 | 50,000 | 180,975 | 819,025 |
| 2 | 819,025 | 230,975 | 40,951 | 190,024 | 629,001 |
| 3 | 629,001 | 230,975 | 31,450 | 199,525 | 429,476 |
| 4 | 429,476 | 230,975 | 21,474 | 209,501 | 219,975 |
| 5 | 219,975 | 230,975 | 11,000 | 219,975 | 0 |
| Total | | 1,154,875 | 154,875 | 1,000,000 | |

When ABC acquires this portfolio at the end of Year 1, the outstanding principal balance of the portfolio is $819,025.

After considering the historical loss experience and reasonable and supportable forecasts over the remaining term of these loans, ABC expects that it will collect the full contractual amount due in Year 2, but only 70% of the payments due in Years 3 to 5.

ABC uses a discounted cash flow method to estimate expected credit losses. It determines that the EIR is 7.97% (rounded), which is the rate that equates the present value of its expected cash flows with the purchase price of $600,000. ABC uses the 7.97% EIR to discount the expected credit losses and estimates

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

that the allowance for expected credit losses at the time of acquisition is $165,464.

ABC's initial cash flow expectations and estimate of credit losses are presented in the following table.

| Year | Expected cash flows | Expected credit losses | Present value of expected credit losses |
|---|---|---|---|
| 2 | 230,975 | 0 | 0 |
| 3 | 161,682 | 69,293 | 59,436 |
| 4 | 161,682 | 69,293 | 55,047 |
| 5 | 161,681 | 69,293 | 50,981 |
| | | | 165,464 |

ABC records the following journal entry at the date of acquisition.

| | Debit | Credit |
|---|---|---|
| Loans | 819,025 | |
| Cash | | 600,000 |
| Allowance for credit losses | | 165,464 |
| Loans – non-credit discount | | 53,561 |
| *To record acquisition of PCD loans, estimate of expected credit losses and non-credit discount.* | | |

The amortized cost at acquisition is $765,464, which is the sum of the purchase price and the initial allowance for credit losses ($600,000 + $165,464). The non-credit discount of $53,561 represents the difference between the principal balance and the amortized cost ($819,025 – $765,464).

ABC subsequently recognizes interest income at the EIR of 7.97% used to discount the expected credit losses.

## **Example 12.3.40** Initial measurement of PCD assets using a non-discounted cash flow method

*Although this example relates to PCD assets, a similar approach would be appropriate for initial measurement of PSLs.*

This example uses the basic facts set out in Example 12.3.30.

However, in contrast to Example 12.3.30, ABC Corp. uses a loss-rate method to estimate its expected credit losses. It estimates its allowance based on the unpaid principal balance and expects losses equal to 30% of the principal payments due in Years 3 to 5. It estimates an allowance for credit losses of $188,700 as shown in the following table.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Contractual principal payments due | Contractual principal payments not expected to be collected |
|---|---|---|
| 2 | 190,024 | 0 |
| 3 | 199,525 | 59,857 |
| 4 | 209,501 | 62,850 |
| 5 | 219,975 | 65,993 |
| | 819,025 | 188,700 |

The allowance of $188,700 equates to a loss rate of 23.04% on the unpaid principal balance of $819,025 at the acquisition date.

ABC records the following journal entry at the date of acquisition.

| | Debit | Credit |
|---|---|---|
| Loans | 819,025 | |
| Cash | | 600,000 |
| Allowance for credit losses | | 188,700 |
| Loans – non-credit discount | | 30,325 |
| *To record acquisition of PCD loans, estimate of expected credit losses and non-credit discount.* | | |

The amortized cost at acquisition is $788,700, which is the sum of the purchase price and the initial allowance for credit losses ($600,000 + $188,700). The non-credit discount of $30,325 represents the difference between the principal balance and the amortized cost ($819,025 – $788,700).

ABC determines that the EIR at which it will subsequently recognize interest income is 6.64% (rounded). This is the rate that equates the present value of the remaining contractual cash flows on the loans ($230,975 × 4) to the amortized cost at acquisition ($788,700).

## 12.4 Subsequent measurement of expected credit losses

### 12.4.10 Overview#

**Excerpt from ASC 326-20**

> Reporting Changes in Expected Credit Losses

**35-1** At each reporting date, an entity shall record an allowance for credit losses on **financial assets** (including **purchased financial assets with credit deterioration** and **purchased seasoned loans**) within the scope of this Subtopic. An entity shall compare its current estimate of expected credit losses with the estimate of expected credit losses previously recorded. An

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

entity shall report in net income (as a credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the allowance for credit losses for management's current estimate of expected credit losses on financial asset(s). Except for purchased seasoned loans that are subject to the guidance in paragraph 326-20-35-1B, the method applied to initially measure expected credit losses for the assets included in paragraph 326-20-30-14 generally would be applied consistently over time and shall faithfully estimate expected credit losses for financial asset(s).

**35-1A** If an entity estimates expected credit losses on purchased seasoned loans using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the entity may elect to measure an allowance for credit losses on purchased seasoned loans using the **amortized cost basis** and apply the guidance in paragraph 326-20-30-2 as of each balance sheet date after the acquisition date. An entity shall elect this option on an acquisition-by-acquisition basis in the period that the acquisition occurs and apply it to all purchased seasoned loans recognized in that acquisition. The effect of electing this option shall be recorded in net income as a credit loss expense.

**35-1B** If an entity elects the option in paragraph 326-20-35-1A, the initial amortized cost basis measured in accordance with paragraph 326-20-30-13 and effective interest rate measured in accordance with paragraph 310-10-35-53B as of the acquisition date shall not be remeasured in connection with electing this option. In addition, expected credit losses shall be measured consistently for the remaining life of the purchased seasoned loans.

PCD assets and PSLs are subsequently measured at amortized cost with expected credit losses estimated at each reporting date. Amortized cost in this instance is:

Any changes in estimates of expected credit losses (both positive and negative) are recognized immediately as a credit loss expense or a reversal of credit loss expense in the period in which they arise. [326-20-35-1]

The non-credit discount or premium at the date of acquisition of PCD assets is accreted or amortized respectively as interest income as discussed in section 12.5. [326-20-35-1, 310-10-35-53B]

Regardless of the method used to determine the Day 1 allowance for credit losses an entity will recognize the same amount of net income – through a combination of interest income and credit loss expense – over the life of the PCD assets or PSLs. However, the amount of interest income and credit loss expense recognized each period will differ based on whether an entity uses a discounted cash flow or a non-discounted cash flow method (e.g. a loss-rate method) to estimate its expected credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12.4.10** For PCD assets and PSLs, does an entity have to maintain the method used to initially estimate expected credit losses for subsequent measurement?**

**Interpretive response:** It depends; the guidance is different for PCD assets versus PSLs.

### *PCD assets*

Subtopic 326-20 generally requires the method chosen to initially estimate expected credit losses on PCD assets to be consistently applied for subsequent measurement. For example, if a method other than a discounted cash flow method (e.g. loss-rate method) is applied to initially estimate expected credit losses, the estimate is based on a PCD asset's unpaid principal balance and the same method is to be consistently applied when subsequently measuring the allowance for credit losses.

The FASB made certain decisions to enable entities to apply consistent tools and methods for both PCD and non-PCD assets. However, using unpaid principal balances as the basis for estimating expected credit losses for PCD assets will create a difference between PCD assets and non-PCD assets – for which the amortized cost is the basis for estimating expected credit losses – when discounted cash flows are not used. This difference may add practical challenges if an entity combines, for subsequent measurement purposes, both PCD assets and non-PCD assets that share similar risk characteristics in one collective assessment. See chapter 5 for more discussion of collective assessments. [ASU 2016-13.BC86]

### *PSLs*

For PSLs, when an entity estimates expected credit losses using a method other than a discounted cash flow method, it initially measures the allowance for credit losses based on the unpaid principal balance. However, it may elect to subsequently measure the allowance for credit losses using the amortized cost basis. [326-20-35-1A]

The election to subsequently measure expected credit losses based on the amortized cost basis must be made in the period of acquisition and is made on an acquisition-by-acquisition basis (i.e. an election applies to all PSLs within that specific acquisition). The effect of the election is recognized immediately in net income as credit loss expense. [326-20-35-1A]

If the entity elects to subsequently measure the allowance for credit losses using the amortized cost basis, the following guidance applies. [326-20-35-1B]

- The initial amortized cost basis and effective interest rate (EIR) determined at the acquisition date are not remeasured.
- Expected credit losses must be measured consistently for the remaining life of the PSLs (i.e. the election is irrevocable).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 12.4.10** Subsequent measurement of PCD assets using a discounted cash flow method

*Although this example relates to PCD assets, a similar approach would be appropriate for subsequent measurement of PSLs using a discounted cash flow method.*

This example uses the basic facts set out in Example 12.3.30.

Continuing with that Example, ABC Corp. subsequently accounts for the loan portfolio from Years 2 to 5 of its life as illustrated below. For simplicity, the following assumptions are made.

- ABC's initial expectation of credit losses remains the same throughout the entire remaining life of the portfolio and that actual losses in each year are in line with initial expectations.
- All loans share the same terms (par amount, term, interest coupon) and have the same credit risk characteristics. Therefore, interest income calculated at the pool level approximates interest income calculated at the individual loan level.
- ABC writes off accrued interest receivable by recognizing credit loss expense – i.e. against the allowance for credit losses (see Question 4.2.50).

| Year | Amort. cost beg. bal. | Cash pmts rec'd[2] | Interest income[3] | Interest rec'd[4] | Principal rec'd[5] | Writeoffs[6] | Amort. cost end. bal.[7] |
|---|---|---|---|---|---|---|---|
| 2 | 765,464[1] | 230,975 | 61,037 | 40,951 | 190,024 | 0 | 595,526 |
| 3 | 595,526 | 161,682 | 47,486 | 22,015 | 139,667 | 69,293 | 412,037 |
| 4 | 412,037 | 161,682 | 32,855 | 15,031 | 146,651 | 69,293 | 213,917 |
| 5 | 213,917 | 161,681 | 17,057 | 7,699 | 153,982 | 69,293 | 0 |
| Total | | 716,020 | 158,435 | 85,696 | 630,324 | 207,879 | |

Notes:

1. Amortized cost at acquisition is the sum of the purchase price and the initial allowance for expected credit losses ($600,000 + $165,464).
2. Actual cash received is 100% of the contractual amount for Year 2 and 70% of the contractual amounts for Years 3 to 5.
3. Interest income is calculated as beginning amortized cost balance × the EIR of 7.97% (rounded).
4. Interest received is 100% of the contractual interest due in Year 2, and 70% of the contractual interest due in Years 3 to 5.
5. Principal received is 100% of the contractual principal due in Year 2, and 70% of contractual principal due in Years 3 to 5.
6. Amounts written off are the contractual principal and interest amounts deemed uncollectible.
7. Amortized cost ending balance = (amortized cost beginning balance + interest income) – (cash payments received + writeoffs of principal and interest).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC records the following journal entries for Year 3.

| | Debit | Credit |
|---|---|---|
| Loans – accrued interest[1] | 31,450 | |
| Loans – non-credit discount[2] | 16,036 | |
| Interest income | | 47,486 |
| *To record interest income at EIR.* | | |
| Cash | 161,682 | |
| Loans | | 139,667 |
| Loans – accrued interest | | 22,015 |
| *To record receipt of cash (principal and interest) at 70% of contractual amounts due.* | | |
| Credit loss expense[3] | 14,246 | |
| Allowance for credit losses | | 14,246 |
| *To record change in present value of expected credit losses due to passage of time.* | | |
| Allowance for credit losses | 69,293 | |
| Loans | | 59,857 |
| Loans – accrued interest | | 9,436 |
| *To record writeoff of principal and interest deemed uncollectible (30% of contractual amounts due in Year 3).* | | |

Notes:

1. The accrued interest is the interest due in Year 3 per the original contractual cash flow schedule.
2. The non-credit discount accreted is the difference between the total interest income of $47,486 less the $31,450 original contractual interest due.
3. ABC elects to report the entire change in present value as a credit loss expense.

The following table shows the roll-forward of the allowance for credit losses.

| Year | Beginning balance | Change in present value due to passage of time[1] | Writeoffs | Ending balance[2] |
|---|---|---|---|---|
| 2 | 165,464 | 13,194 | 0 | 178,658 |
| 3 | 178,658 | 14,246 | 69,293 | 123,611 |
| 4 | 123,611 | 9,857 | 69,293 | 64,175 |
| 5 | 64,175 | 5,118 | 69,293 | 0 |

Notes:

1. Represents the periodic effect on the allowance due to the passage of time, calculated as the beginning balance of the allowance × the EIR of 7.97% (rounded). ABC may present this change in present value attributable to passage

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

of time either as credit loss expense or as a reduction of interest income. [326-20-45-3]

2. Ending balance = beginning balance + change in the present value due to the passage of time – writeoffs of principal and interest.

## Example 12.4.20 Subsequent measurement of PCD assets using a non-discounted cash flow method

*Although this example relates to PCD assets, a similar approach can also be applied to the subsequent measurement of PSLs using a non-discounted cash flow method. However, this example demonstrates estimating expected credit losses based on the unpaid principal balance. As explained in Question 12.4.10, an entity using a method other than a discounted cash flow method may also elect to subsequently estimate expected credit losses on PSLs based on the amortized cost basis instead of the unpaid principal balance.*

This example uses the basic facts set out in Example 12.3.30, as modified by Example 12.3.40.

Continuing with Example 12.3.40, ABC Corp. subsequently accounts for the loan portfolio from Years 2 to 5 of its life as illustrated below. For simplicity, the following assumptions are made.

- ABC's initial expectation of credit losses remains the same throughout the entire remaining life of the portfolio and that actual losses in each year are in line with initial expectations.
- The loans remain on accrual status throughout their life; therefore, the accrued interest is included in the estimate of expected credit losses when, and only when, recognized.
- All loans share the same terms (par amount, term, interest coupon) and have the same credit risk characteristics. Therefore, interest income calculated at the pool level approximates interest income calculated at the individual loan level.
- ABC measures an allowance for credit losses for accrued interest receivable. Additionally, ABC writes off accrued interest receivable by recognizing credit loss expense – i.e. against the allowance for credit losses (see Question 4.2.50).

| Year | Amort. cost beg. bal. | Cash pmts rec'd[2] | Interest income[3] | Interest rec'd[4] | Principal rec'd[5] | Writeoffs[6] | Amort. cost end. bal.[7] |
|---|---|---|---|---|---|---|---|
| 2 | 788,700[1] | 230,975 | 52,396 | 40,951 | 190,024 | 0 | 610,121 |
| 3 | 610,121 | 161,682 | 40,533 | 22,015 | 139,667 | 69,293 | 419,679 |
| 4 | 419,679 | 161,682 | 27,881 | 15,031 | 146,651 | 69,293 | 216,585 |
| 5 | 216,585 | 161,681 | 14,389 | 7,699 | 153,982 | 69,293 | 0 |
| Total | | 716,020 | 135,199 | 85,696 | 630,324 | 207,879 | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Notes:

1. Amortized cost at acquisition is the sum of the purchase price and the initial allowance for expected credit losses ($600,000 + $188,700).
2. Actual cash received is 100% of the contractual amount for Year 2 and 70% of the contractual amounts for Years 3 to 5.
3. Interest income is calculated as beginning amortized cost balance × EIR of 6.64% (rounded). The rate of 6.64% (rounded) is the rate that equates the present value of the contractual payments ($230,975 × 4) to the initial amortized cost ($788,700).
4. Interest received is 100% of the contractual interest due in Year 2, and 70% of the contractual interest due in Years 3 to 5.
5. Principal received is 100% of the contractual principal due in Year 2, and 70% of contractual principal amount due in Years 3 to 5.
6. Amounts written off are the contractual principal and interest amounts deemed uncollectible.
7. Amortized cost ending balance = (amortized cost beginning balance + interest income) less (cash payments received + writeoffs of principal and interest).

ABC records the following journal entries for Year 3.

| | Debit | Credit |
|---|---|---|
| Loans – accrued interest[1] | 31,450 | |
| Loans – non-credit discount[2] | 9,083 | |
| Interest income | | 40,533 |
| *To record interest income at EIR.* | | |
| Cash | 161,682 | |
| Loans | | 139,667 |
| Loan – accrued interest | | 22,015 |
| *To record receipt of cash (principal and interest) at 70% of contractual amounts due.* | | |
| Credit loss expense | 9,436 | |
| Allowance for credit losses | | 9,436 |
| *To record credit losses for accrued interest not expected to be collected.* | | |
| Allowance for credit losses | 69,293 | |
| Loans | | 59,857 |
| Loans – accrued interest | | 9,436 |
| *To record writeoff of principal and interest amounts deemed uncollectible (30% of contractual amounts due in Year 3).* | | |

Notes:

1. The accrued interest is the interest due in Year 3 per the original contractual cash flow schedule.
2. The non-credit discount accreted is the difference between the total interest income of $40,533 less the $31,450 original contractual interest due.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The following table shows the roll-forward of the allowance for credit losses.

| Year | Beginning balance | Credit loss expense[1] | Writeoffs of principal and interest | Ending balance[2] |
|---|---|---|---|---|
| 2 | 188,700 | 0 | 0 | 188,700 |
| 3 | 188,700 | 9,436 | 69,293 | 128,843 |
| 4 | 128,843 | 6,443 | 69,293 | 65,993 |
| 5 | 65,993 | 3,300 | 69,293 | 0 |

Notes:

1. Represents the additional provision to be recognized for the accrued interest not expected to be collected in each of the years – i.e. 30% of contractual interest amounts due each year.
2. Ending balance = beginning balance + credit loss expense – writeoffs of principal and interest.

## Question 12.4.20 Must an entity maintain the integrity of a pool of PCD assets or PSLs?#

**Interpretive response:** No. The integrity of a pool of PCD assets or PSLs is not required to be maintained. New assets may be added to the pool as long as all the assets in the pool share similar risk characteristics. Similarly, if certain assets no longer share similar risk characteristics with the other assets in the pool, they should be removed from the original pool and included in another pool. For further discussion of collective assessments, see section 5.2. [326-20-35-2]

The integrity of a pool need not be maintained because under Subtopic 326-20 the individual assets represent the unit of account even though they are pooled together for the purpose of estimating expected credit losses. As discussed in section 12.3.10, the allowance for credit losses is allocated to the individual PCD assets and PSLs in the pool to determine each individual asset's amortized cost and non-credit premium or discount, which is consistent with the individual assets being the unit of account. [326-20-30-13]

For guidance on accounting for legacy GAAP pools of PCI assets, see section 12.6.

## 12.4.20 Expected recoveries of PCD assets#

### Excerpt from ASC 326-20

> Purchased Financial Assets with Credit Deterioration and Purchased Seasoned Loans

**30-13A** The allowance for credit losses for purchased financial assets with credit deterioration shall include expected recoveries of amounts previously

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

written off and expected to be written off by the entity and shall not exceed the aggregate of amounts previously written off and expected to be written off by the entity.

a. If the entity estimates expected credit losses using a method other than a discounted cash flow method in accordance with paragraph 326-20-30- 4, expected recoveries shall not include any amounts that result in an acceleration of the noncredit discount.
b. The entity may include increases in expected cash flows after acquisition.

(See Examples 18 and 19 in paragraphs 326-20-55-86 through 55-90.)

As discussed in section 3.3.10, an entity is required to recognize writeoffs (full or partial) of financial assets in the period in which they are deemed uncollectible. Further, the allowance for credit losses is required to include expected recoveries of amounts previously written off and expected to be written off, which may result in the allowance for credit losses being negative (i.e. a debit balance). The negative allowance for credit losses may not exceed amounts previously written off (or expected to be written off). [326-20-30-1, 30-13A, 35-8]

Subtopic 326-20 includes incremental guidance for recognizing expected recoveries of PCD assets. The incremental guidance clarifies that an entity: [326-20-30-13A]

- should not include in expected recoveries any amounts that result in an acceleration of the non-credit discount when a method other than a discounted cash flow method is used to estimate expected credit losses (referred to as a 'recovery cap'); and
- may include increases in expected cash flows after acquisition.

The incremental guidance for recognizing expected recoveries of PCD assets in this section 12.4.20 does not apply to PSLs (that is, PSLs are not subject to a 'recovery cap').

See also section 12.4.30 for FASB examples of expected recoveries.

## **Question 12.4.30** When using a method other than a discounted cash flow method, how does an entity ensure expected recoveries on PCD assets do not accelerate recognition of the non-credit discount?

**Interpretive response:** Recognition of amounts previously written off and expected to be written off on PCD assets by an entity must not result in an accelerated recognition of the non-credit discount. We believe one acceptable approach to prevent accelerated recognition of the non-credit discount for previously written-off PCD assets is to: [326-20-30-13A, 55-86 – 55-90]

- deduct the non-credit discount that existed immediately before the writeoff from the total recoveries expected to be received on those assets; and

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- apply recoveries received first to the negative allowance, with additional income recognized when recoveries received exceed the negative allowance.

Under this approach, in periods following a writeoff, the negative allowance continues to reflect total expected recoveries less the non-credit discount. As a result, increases in expected recoveries generally result in an increase in the negative allowance and a reduction in credit loss expense.

The Board's intent when providing this limit on recognition of expected recoveries was to ensure that an entity does not accelerate recognition of income when it writes off a PCD asset. Reducing expected recoveries by the non-credit discount achieves this objective. [ASU 2019-11.BC10]

We believe other approaches to prevent accelerated recognition of the non-credit discount may be acceptable depending on the specific facts and circumstances.

## **Example 12.4.30** Recognizing expected recoveries of PCD assets when a method other than a discounted cash flow method is used to estimate credit losses

This example illustrates one method (as described in Question 12.4.30) of recognizing expected recoveries of amounts previously written off for a PCD asset over its life.

***Assumptions***

Bank acquires a non-interest bearing loan on January 1, Year 1 and determines that the loan has experienced a more-than-insignificant deterioration in credit quality at that date as compared to its origination date. Therefore, Bank concludes it will account for the loan under the guidance for PCD assets. Bank uses a method other than a discounted cash flow method to estimate its expected credit losses.

The loan has the following attributes at acquisition.

| | |
|---|---|
| Remaining par amount: | 10,000,000 |
| Purchase price: | 2,000,000 |
| Expected collections of the unpaid principal balance: | 2,500,000 |
| Contractual payments not expected to be collected | 7,500,000 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

***Journal entry at acquisition***

Bank records the following journal entry at the date of acquisition.

| | Debit | Credit |
|---|---|---|
| Loan | 10,000,000 | |
| Cash | | 2,000,000 |
| Allowance for credit losses | | 7,500,000 |
| Loan – non-credit discount | | 500,000 |
| *To record purchase of a PCD loan, estimate of expected credit losses and non-credit discount.* | | |

***Year 1***

During Year 1, no collections are received. Bank records the following journal entry to accrete a portion of the non-credit discount into interest income for Year 1; this is because Bank has a reasonable expectation about the amounts expected to be collected.

| | Debit | Credit |
|---|---|---|
| Loans – non-credit discount | 150,000 | |
| Interest income | | 150,000 |
| *To record accretion of non-credit discount.* | | |

During Year 1, Bank decreases its estimate of expected collections of the unpaid principal balance from $2,500,000 to $2,100,000, resulting in an increase in expected credit losses of $400,000. Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 400,000 | |
| Allowance for credit losses | | 400,000 |
| *To record increase in expected credit losses.* | | |

At the end of Year 1, Bank's financial statements include the following amounts related to the loan:

| Account | Year 1 |
|---|---|
| **Balance sheet – assets** | |
| Principal balance | 10,000,000 |
| Non-credit discount (unamortized portion) | (350,000) |
| Amortized cost | 9,650,000 |
| Allowance for credit losses | (7,900,000) |
| Net carrying amount | 1,750,000 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Account | Year 1 |
|---|---|
| **Income statement** | |
| Interest income | 150,000 |
| Credit loss expense | 400,000 |

***Year 2***

During Year 2, Bank determines that the loan is uncollectible and writes off the entire balance in accordance with its writeoff policy. While the individual loan is considered uncollectible, it becomes part of the pool of charged-off loans for which Bank's expectation, consistent with previous experience, is that it will receive recoveries from some individual loans within the pool. However, Bank does not yet know for which specific loans there will be a recovery.

For simplicity, this example illustrates an expected recovery of $2,100,000 at the individual loan level even though it would be measured at the aggregate pool level. It is assumed that no additional interest income is recognized and no payments are received during this period.

Bank records the following journal entries.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 1,750,000 | |
| Allowance for credit losses | | 1,750,000 |
| *To increase allowance for credit losses to equal loan's amortized cost.* | | |
| Loan – non-credit discount | 350,000 | |
| Allowance for credit losses | 9,650,000 | |
| Loans | | 10,000,000 |
| *To record writeoff of PCD loan.* | | |
| Allowance for credit losses[1] | 1,750,000 | |
| Credit loss expense | | 1,750,000 |
| *To record expected recovery of fully written-off PCD loan.* | | |

Note:

1. Expected recovery ($2,100,000) – non-credit discount existing at the date of writeoff ($350,000). As required, the $1,750,000 negative allowance for credit losses recognized is less than the loan's amortized cost basis that was written off ($9,650,000).

At the end of Year 2, Bank's balance sheet includes the following amount related to the loan. No amounts are reported in its income statement related to the loan.

| Account | Year 2 |
|---|---|
| **Balance sheet – assets** | |
| Allowance for credit losses[1] | 1,750,000 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Note:
1. The $1,750,000 amount represents a negative allowance for credit losses.

***Year 3***

During Year 3, Bank increases its estimate of expected collections of the unpaid principal balance from $2,100,000 to $5,000,000. As a result, it increases the negative allowance to reflect the new estimate of expected recoveries less the non-credit discount that existed immediately prior to a writeoff. It is assumed that no payments are received during this period.

Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Allowance for credit losses[1] | 2,900,000 | |
| Credit loss expense | | 2,900,000 |
| *To record expected recovery of PCD loan that results in negative allowance.* | | |

Note:
1. Expected recovery ($5,000,000) – non-credit discount existing at the date of writeoff ($350,000) – existing negative allowance ($1,750,000). As required, the $4,650,000 negative allowance for credit losses recognized is less than the loan's amortized cost basis that was written off ($9,650,000).

At the end of Year 3, Bank's financial statements include the following amounts related to the loan.

| Account | Year 3 |
|---|---|
| **Balance sheet – assets** | |
| Allowance for credit losses[1] | 4,650,000 |
| **Income statement** | |
| Credit loss expense (negative amount) | (2,900,000) |

Note:
1. The $4,650,000 amount represents a negative allowance for credit losses.

***Year 4***

During Year 4, Bank receives $3,000,000 in recoveries. Its expected collections of the unpaid principal balance remain unchanged from Year 3 – i.e. its remaining estimate of expected cash flows is $2,000,000; this represents its estimate in Year 3 of $5,000,000 less recoveries received of $3,000,000.

Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Cash | 3,000,000 | |
| Allowance for credit losses | | 3,000,000 |
| *To record recovery received.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

At the end of Year 4, Bank's balance sheet includes the following amount related to the loan. No amounts are reported in its income statement related to the loan.

| Account | Year 4 |
|---|---|
| **Balance sheet – assets** | |
| Allowance for credit losses – negative[1] | 1,650,000 |

Note:

1. Expected recovery ($2,000,000) – non-credit discount existing at the date of writeoff ($350,000). The $1,650,000 amount represents a negative allowance for credit losses. As required, the negative allowance for credit losses recognized is less than $6,650,000, which represents the loan's amortized cost basis that was written off ($9,650,000), net of recoveries received ($3,000,000).

***Year 5***

During Year 5, Bank receives $2,000,000 in recoveries. It does not expect to receive any further recoveries on the loan.

Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Cash | 2,000,000 | |
| Allowance for credit losses | | 1,650,000 |
| Income[1] | | 350,000 |
| *To record recovery received.* | | |

Note:

1. Presentation of this amount in the income statement is not specified by Subtopic 326-20.

At the end of Year 5, Bank's balance sheet no longer includes any amounts related to the loan and its income statement includes $350,000 of income.

By recording a negative allowance for credit losses only for the excess of expected recoveries at each reporting date over the unamortized non-credit discount at the date of writeoff, Bank avoided accelerating recognition of the non-credit discount into earnings.

## 12.4.30 FASB examples of expected recoveries

FASB Examples 18 and 19 illustrate including expected recoveries of amounts previously written off and expected to be written off in the allowance for credit losses. In each of these examples, the negative allowance is recognized for the excess of expected recoveries at the reporting date over the unamortized non-credit discount at the date of writeoff, which is less than the amortized cost written off in both examples. This prevents an entity from accelerating the non-credit discount into earnings.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Excerpt from ASC 326-20

• > Example 18: Determining the Negative Allowance for Purchased Financial Assets with Credit Deterioration with No Change in Credit Conditions

**55-86** The following Example illustrates the application of the guidance in paragraph 326-20-30-13A for purchased financial assets with credit deterioration. For purposes of this Example, the acquired portfolio of loans is assumed to share similar risk characteristics and is evaluated for credit losses on a collective basis.

**55-87** Bank Q purchases a portfolio of loans with a par amount of $10 million for $2 million. At acquisition, Bank Q expects to collect $2.5 million on the loan portfolio. Bank Q estimates expected credit losses using a method other than a discounted cash flow method in accordance with paragraph 326-20-30-4. The acquisition-date journal entry is as follows.

| | | |
|---|---|---|
| Loan – par amount | $ 10,000,000 | |
| Loan – noncredit discount | | $ 500,000 |
| Allowance for credit losses | | 7,500,000 |
| Cash | | 2,000,000 |

**55-88** After acquisition, Bank Q determines that each loan is deemed uncollectible on an individual unit-of-account basis and, therefore, writes off the loan portfolio. The following journal entries are recorded.

| | | |
|---|---|---|
| Provision expense | $ 2,000,000 | |
| Allowance for credit losses | | $ 2,000,000 |
| Allowance for credit losses | $ 9,500,000 | |
| Loan – noncredit discount | 500,000 | |
| Loan – par amount | | $ 10,000,000 |

**55-89** Although deemed uncollectible on an individual basis, when grouped together, the group of loans is expected to have some recoveries on an aggregate basis. Therefore, Bank Q records a negative allowance in accordance with paragraph 326-20-30-13A. Because Bank Q's expectation of credit conditions has not changed since acquisition, the expected recoveries of $2.5 million must not result in the acceleration of the noncredit discount that existed immediately before being written off. Therefore, the following journal entry is recorded.

| | | |
|---|---|---|
| Allowance for credit losses | $ 2,000,000 | |
| Provision expense | | $ 2,000,000 |

• > Example 19: Determining the Negative Allowance for Purchased Financial Assets with Credit Deterioration after a Change in Credit Conditions

**55-90** Assume the same facts from Example 18. Bank Q subsequently determines that a change in credit conditions has occurred and expects to collect an additional $600,000 (for a total of $3.1 million) on the group of loans.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Because Bank Q's expectation of credit conditions has changed and it is determining the amount that it expects to collect using a method other than a discounted cash flow method, the expected recoveries of $3.1 million would be reduced by the noncredit discount of $0.5 million (that has not been accreted). This would result in Bank Q having an overall negative allowance of $2.6 million. Therefore, the following journal entry is recorded.

| | | |
|---|---|---|
| Allowance for credit losses | $ 600,000 | |
| Provision expense | | $ 600,000 |

## 12.5 Interest income recognition

### 12.5.10 Overview#

**Excerpt from ASC 310-10**

• > Interest Income

**35-53A** Except as noted in paragraphs 310-10-35-53B through 35-53C, this Subsection does not address how a creditor should recognize, measure, or display interest income on a financial asset with a credit loss. Some accounting methods for recognizing income may result in an amortized cost basis of a financial asset that is less than the amount expected to be collected (or, alternatively, the fair value of the collateral). Those accounting methods include recognition of interest income using a cost-recovery method, a cash-basis method, or some combination of those methods.

**35-53B** When recognizing interest income on **purchased financial assets with credit deterioration** and **purchased seasoned loans** within the scope of Topic 326, an entity shall not recognize as interest income the discount embedded in the purchase price that is attributable to the acquirer's assessment of expected credit losses at the date of acquisition. The entity shall accrete or amortize as interest income the non-credit-related discount or premium of a purchased financial asset with credit deterioration and a purchased seasoned loan in accordance with existing applicable guidance in Section 310-20-35 or 325-40-35.

**35-53C** Recognition of income on purchased financial assets with credit deterioration is dependent on having a reasonable expectation about the amount expected to be collected. Subsequent to purchase, this Subtopic does not prohibit placing financial assets on nonaccrual status, including use of the cost recovery method or cash basis method of income recognition, when appropriate. For example, if the timing of either a sale of the financial asset into the secondary market or a sale of collateral in essentially the same condition as received upon foreclosure is indeterminate, the creditor likely does not have the information necessary to reasonably estimate cash flows expected and shall cease recognizing income on the financial asset. However, the ability to place a financial asset on nonaccrual shall not be used to circumvent recognition of a credit loss. If the financial asset is acquired primarily for the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

rewards of ownership of the underlying collateral, accrual of income is inappropriate. Such rewards of ownership would include use of the collateral in operations of the entity or improving the collateral for resale. Consistent with paragraph 310-20-35-18, interest income shall not be recognized to the extent that the net investment in the financial asset would increase to an amount greater than the payoff amount.

Under Subtopic 310-10, interest income for PCD assets and PSLs is recognized by accreting the non-credit premium or discount of the PCD assets and PSLs using the interest method. In contrast, the Day 1 allowance for credit losses does not result in an accretable discount. [310-10-35-53B]

For PCD assets only, Subtopic 326-20 specifies that recognition of income requires a reasonable expectation about the amounts expected to be collected. When an entity does not have a reasonable expectation about the amount expected to be collected, nonaccrual policies are applied. [310-10-35-53C]

### **Question 12.5.10** Does an entity recognize the non-credit discount for PCD assets and PSLs at a pool level?#

**Interpretive response:** Generally, no. As explained in section 12.3.10, Subtopic 326-20 requires allocating any non-credit discount or premium resulting from acquiring a pool of PCD assets or PSLs to individual assets in the pool. Further, the non-credit related discount or premium of a PCD asset or a PSL is accreted or amortized as interest income under the existing guidance in Sections 310-20-35 or 325-40-35. However, if an entity elected to maintain previously existing pools on adoption of Topic 326, the pool continues to be the unit of account (see section 12.6). [326-20-30-13, 310-10-35-53B]

### **Question 12.5.20** May a PCD asset or PSL be placed on nonaccrual status?#

**Interpretive response:** It depends. An entity applies nonaccrual policies to discontinue recognizing interest income on PCD assets when it does not have a reasonable expectation about the amounts expected to be collected, as required by Subtopic 320-20 for PCD assets. This requirement does not apply to other financial assets (including PSLs), although an entity is permitted to have nonaccrual policies for non-PCD financial assets (including PSLs). However, placing a financial asset on nonaccrual status cannot be used to circumvent recognition of a credit loss. [310-10-35-53C]

## 12.6 Accounting for legacy GAAP pools of PCI assets maintained at transition

The definition of PCD assets under Topic 326 is different from the definition of purchased credit impaired loans (PCI assets) under Subtopic 310-30 of legacy

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

US GAAP. Despite these different definitions, when adopting Topic 326, generally an entity did not evaluate any existing assets to determine whether they met the PCD definition. Rather, any existing PCI assets accounted for under Subtopic 310-30 automatically became PCD assets.

An entity applied Topic 326 prospectively to PCI assets previously accounted for under Subtopic 310-30. At the adoption date, an entity applied PCD accounting by recognizing the addition of an allowance for credit losses and making a corresponding adjustment to the assets' amortized cost basis.

However, the transition provisions in Topic 326 permitted an entity to elect to maintain pools of loans accounted for under Subtopic 310-30. Additionally, the TRG agreed that after adoption an entity could elect to continue to maintain previous (legacy GAAP) pools on a pool-by-pool basis. [326-10-65-1(d), TRG 06-17.3, TRG 06-17.6]

If an entity elected to maintain the legacy GAAP pools after adoption, it did not reassess the pool composition of the loans for purposes of estimating expected credit losses. [TRG 06-17.3, TRG 06-17.6]

Additionally, the TRG clarified that those paragraphs of legacy US GAAP guidance that are relevant to the pool as the unit of account – which include paragraphs 310-30-15-6, 310-30-35-15, and 310-30-40-1 to 310-30-40-2 (reproduced below) – continue to be relevant when an entity elects to maintain the pool as the unit of account subsequent to adopting Topic 326. However, other aspects of Topic 326 apply regardless of whether an entity elected to maintain pools of loans accounted for under Subtopic 310-30. [TRG 06-17.3, TRG 06-17.6]

Because the TRG guidance was meant as an accommodation to permit entities to continue to use existing systems and processes upon adopting Topic 326, we generally expect that entities continue leveraging their existing discounted cash flow methodology when applying this guidance.

## Excerpt from ASC 310-30 (superseded)

> Other Considerations

**15-6** For purposes of applying the recognition, measurement, and disclosure provisions of this Subtopic for loans that are not accounted for as debt securities, investors may aggregate loans acquired in the same fiscal quarter that have **common risk characteristics** and thereby use a composite interest rate and expectation of cash flows expected to be collected for the pool. It is not intended for this aggregation to be analogized for purposes other than this Subtopic. To be eligible for aggregation, each loan first should be determined individually to meet the scope criteria of paragraph 310-30-15-2. After determining that certain acquired loans are within the scope as defined in that paragraph, the investor may evaluate whether such loans have common risk characteristics, thus permitting the aggregation of such loans into one or more pools. The aggregation shall be based on common risk characteristics that include similar credit risk or risk ratings, and one or more predominant risk characteristics. A portion of the total cost of acquired assets shall be assigned to each unit of accounting acquired on the basis of its relative fair value at the date of acquisition. The excess of the contractually required payments receivable over the investor's **initial investment** (whether **accretable yield** or

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**nonaccretable difference**) for a specific loan or a pool of loans with one set of common risk characteristics shall not be considered available to offset changes in cash flows expected to be collected from a different loan or an assembled pool of loans with another set of common risk characteristics.

> Pool of Multiple Loans

**35-15** If a loan is removed from a pool of loans, the difference between the loan's carrying amount and the fair value of the collateral or other assets received shall not affect the percentage yield calculation used to recognize accretable yield on the pool of loans.

> Pool of Multiple Loans

**40-1** Once a pool of loans is assembled, the integrity of the pool shall be maintained. A **loan** shall be removed from a pool of loans only if either of the following conditions is met:

a. The investor sells, forecloses, or otherwise receives assets in satisfaction of the loan.
b. The loan is written off.

A refinancing or restructuring of a loan shall not result in the removal of a loan from a pool.

**40-2** A loan removed from a pool in accordance with the preceding paragraph shall be removed at its carrying amount. See paragraph 310-30-35-15 for further guidance on removing a loan from a pool.

## **Question 12.6.10** How does accounting for PCD assets differ when an entity elected to maintain legacy GAAP pools of loans?

**Interpretive response:** The following table compares accounting under Subtopic 326-20 when an entity elected to maintain versus elected *not* to maintain previous (legacy GAAP) pools after adoption.

| Question | Legacy GAAP pools *not* maintained after adoption | Legacy GAAP pools maintained after adoption |
|---|---|---|
| **What method is used for determining credit losses?** | Allowance for lifetime expected credit losses is recognized using either a discounted or undiscounted approach. [326-20-30-3] | Allowance for lifetime expected credit losses is generally expected to be recognized using a discounted approach to leverage systems and processes developed under legacy GAAP. |
| **How are subsequent changes in cash flows recognized?** | Subsequent changes (favorable and unfavorable) in expected cash flows are recognized immediately in net income by adjusting the allowance. [326-20-35-1] | Consistent with Subtopic 326-20 when legacy pools are not maintained. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Question | Legacy GAAP pools *not* maintained after adoption | Legacy GAAP pools maintained after adoption |
|---|---|---|
| **Must an entity maintain the integrity of a pool?** | Integrity of the pool is not maintained. If an asset no longer shares similar risk characteristics, it is removed from the pool. [326-20-30-2] | Individual loans generally cannot be removed from the pool except in the event of sale, foreclosure, settlement or writeoff of a loan. [310-30-40-1] |
| **How are writeoffs determined?** | Writeoff determined at the individual asset level. [326-20-35-8] | There is no specific guidance for accounting for writeoffs. However, an entity needs to consider whether writeoff policies should address the effect of applying Subtopic 326-20 to the pools. For example, an entity considers when allowance amounts established at transition through the initial PCD gross-up should be written off. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 12A. Business combinations and asset acquisitions

## Detailed contents

Item significantly updated in this edition: #

**12A.1 How the standard works#**

**12A.2 Scope and initial measurement#**

**Questions**

**Question 12A.2.10** Is an agreement to acquire a business that holds financial assets in the scope of Subtopic 326-20?

**Question 12A.2.20** Does the allowance for credit losses equal the credit portion of a purchase discount when estimating the fair value of a financial asset?

**Question 12A.2.30** Can an entity use the same inputs to estimate the allowance for credit losses and determine the fair value of financial assets acquired?

**Question 12A.2.40** Can an entity offset an unamortized purchase discount against its expectation of credit losses?

**Question 12A.2.50** How does an entity recognize an allowance for credit losses related to loan commitments assumed in a business combination?

**Question 12A.2.60** Do the PCD asset and PSL accounting models apply to assets acquired in a business combination?#

**Question 12A.2.70** Does an acquirer/purchaser apply PCD accounting to financial assets previously written off by the acquiree/seller?

**Question 12A.2.80** Do the PCD asset and PSL accounting models apply to off-balance sheet credit exposures assumed in a business combination?#

**Question 12A.2.90** If pushdown accounting is elected, is PCD asset and PSL accounting at the parent level pushed down in the stand-alone financial statements of the acquiree?#

**Examples**

**Example 12A.2.10** Loan commitment assumed in a business combination

**Example 12A.2.20** Acquisition of bank with PCD assets

**Example 12A.2.30** Acquisition of bank with assets that are not PCD#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 12A.3 Measurement period considerations for a business combination

### Questions

**Question 12A.3.10** During the measurement period, can an acquirer reevaluate and change assets to which PCD asset accounting or PSL accounting is applied?#

**Question 12A.3.20** How are measurement period adjustments related to PCD assets accounted for?#

### Example

**Example 12A.3.10** Applying the measurement period guidance to purchased financial assets#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 12A.1 How the standard works#

*This chapter is written as if ASU 2025-08, which introduced the concept of purchased seasoned loans (PSLs), is fully effective. Because the ASU introduces significant and pervasive changes to the accounting for acquired financial assets, readers should be aware that certain requirements described here may not yet be effective for entities that have not elected early adoption of the ASU. See section 25.3 for transition and effective dates guidance for ASU 2025-08.*

Subtopic 326-20 requires lifetime expected credit losses of a financial asset in the scope of 326-20 to be recognized when the asset is purchased. This applies to acquisitions of financial assets in connection with:

- a business combination (Subtopics 805-10 to 805-30); and
- purchases outside of a business combination, such as asset acquisitions in the scope of Subtopic 805-50.

This chapter focuses on aspects of applying the expected credit loss model to financial assets that are specific to assets purchased in a business combination or asset acquisition.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 12A.2 Scope and initial measurement#

When an acquirer obtains control of an acquiree in a business combination, it recognizes the identifiable assets acquired, liabilities assumed and noncontrolling interests at fair value, with limited exceptions. When an acquirer obtains assets in connection with an asset acquisition (which does not meet the definition of a business), the acquirer measures the acquired assets based on their cost, which is generally allocated to the assets on a relative fair value basis. [805-20-30-1 – 30-2, 805-50-30-1]

Subtopic 326-20 provides additional guidance on how to initially recognize financial assets acquired that are in its scope, including the effect of PCD asset and PSL accounting, if applicable.

### **Question 12A.2.10** Is an agreement to acquire a business that holds financial assets in the scope of Subtopic 326-20?

**Background:** Some entities enter into an agreement to acquire a business at a future date, and many such businesses hold financial assets. Subtopic 805-20 provides guidance on the accounting for an acquired set of assets and activities that constitutes a business, requiring acquisition accounting to be applied at the date of acquisition. The accounting for business combinations is the subject of KPMG Handbook, Business combinations.

Question 13.2.20 discusses forward commitments to purchase loans that are not in connection with the acquisition of a business.

**Interpretive response:** No. We do not believe an agreement to acquire a business in a future business combination that will be in the scope of Subtopic 805-20 is in the scope of Subtopic 326-20. This is regardless of whether the business to be acquired holds financial assets.

The scope of Subtopic 326-20 applies only to off-balance sheet loan commitments, standby letters of credit, financial guarantees (not accounted for as insurance or a derivative) and other similar instruments. We do not believe an agreement to acquire a business should be considered the same as, or 'similar' to, any of the off-balance sheet credit exposures listed in Subtopic 326-20, including loan commitments. [326-20-15-2(c)]

This view is consistent with the guidance in Subtopic 805-20 that prohibits the recognition of liabilities that will be incurred upon the consummation of a business combination until the acquisition date. [805-20-55-50 – 55-51]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12A.2.20** Does the allowance for credit losses equal the credit portion of a purchase discount when estimating the fair value of a financial asset?

**Interpretive response:** Generally, no. The allowance for expected credit losses and the credit portion of a purchase discount when measuring the fair value of a financial asset are different estimates with distinctly different objectives.

Some of the key differences between the estimates are as follows.

- The allowance for credit losses is the estimate of lifetime expected credit losses. In contrast, the credit portion of a purchase discount when estimating fair value typically represents the *change* in the estimate of lifetime credit losses since origination and/or the change in the market's appetite for that credit risk (market credit spreads). For example, on the date that a loan is originated, there will be an allowance for credit losses based on estimated lifetime expected credit losses. However, there would not be a purchase discount related to credit risk on the date of origination because there would not have been any credit deterioration since origination.
- The allowance for credit losses does not consider whether the expected interest payments are adequate compensation for the credit risk assumed by the lender. In contrast, a fair value measurement considers whether the expected interest payments are adequate compensation for the credit risk assumed by the lender.
- The allowance for credit losses is based on an entity's own estimate of expected credit losses. In contrast, a fair value measurement is based on market participant assumptions, including assumptions about credit risk.

The calculation of the allowance for credit losses is different from that generally used for measuring fair value. When a discounted cash flow method is used, the allowance for credit losses is calculated as the difference between the amortized cost (which is effectively the present value of *contractual* cash flows discounted at the financial asset's effective interest rate) and the present value of *expected* cash flows discounted at the financial asset's effective interest rate. In contrast, a fair value measurement using a discounted cash flow method is generally based on either (1) contractual cash flows discounted at a market interest rate, inclusive of credit spreads, or (2) credit-adjusted cash flows discounted at an interest rate that excludes credit spreads. [326-20-30-4, CON 7.42–54]

## **Question 12A.2.30** Can an entity use the same inputs to estimate the allowance for credit losses and determine the fair value of financial assets acquired?

**Interpretive response:** It depends. The allowance for credit losses is based on an entity's own estimate of expected credit losses. In contrast, fair value measurements are based on market participant assumptions, including assumptions about credit risk. That is, fair value is a market-based

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

measurement, not an entity-specific measurement. Therefore, we believe if an entity uses the same inputs to determine fair value as it used to estimate the allowance for credit losses, it needs to support that the inputs (e.g. probability of default and loss-given-default) are based on assumptions that are consistent with market participant assumptions.

## **Question 12A.2.40** Can an entity offset an unamortized purchase discount against its expectation of credit losses?

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-5** If an entity estimates expected credit losses using a method other than a discounted cash flow method described in paragraph 326-20-30-4, the allowance for credit losses shall reflect the entity's expected credit losses of the amortized cost basis of the financial asset(s) as of the reporting date. For example, if an entity uses a loss-rate method, the numerator would include the expected credit losses of the amortized cost basis (that is, amounts that are not expected to be collected in cash or other consideration, or recognized in income). In addition, when an entity expects to accrete a discount into interest income, the discount should not offset the entity's expectation of credit losses. An entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the following components of the amortized cost basis, including all of the following…:

**Interpretive response:** No. When financial assets are acquired with a fair value less than the unpaid principal balance, a purchase discount is recorded and subsequently accreted into interest income. An entity may not use the unamortized discount to offset or otherwise reduce its estimate of expected credit losses. [326-20-30-5]

## **Question 12A.2.50** How does an entity recognize an allowance for credit losses related to loan commitments assumed in a business combination?

**Interpretive response:** An entity is required to recognize a liability for the fair value of assumed loan commitments when recording a business combination. We believe Subtopic 326-20 requires an entity to separately recognize, through earnings, a liability related to the credit exposure arising from these commitments. This means that any liability established through acquisition accounting related to these commitments does not offset the entity's estimate of expected credit losses. [326-20-30-5, ASU 2016-13.BC97]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

This outcome is similar to the treatment of non-PCD loans acquired in a business combination whereby a discount established through acquisition accounting does not offset the entity's estimate of expected credit losses. Further, the recognition of expected credit losses is not an acquisition accounting adjustment that affects goodwill (see Question 12A.2.60).

Because the liability established at fair value as part of the business combination is accounted for separately, we believe that liability is subsequently accounted for in a manner similar to a commitment fee that is subject to the guidance in Subtopic 310-20. Under that guidance, a commitment fee generally is deferred and recognized as an adjustment of yield when the commitment is exercised; an exception arises if the likelihood of exercise is remote, in which case it is recognized on a straight-line basis. [310-20-35-3]

## **Example 12A.2.10** Loan commitment assumed in a business combination

Bank ABC acquires Bank DEF in a transaction accounted for as a business combination. As part of the business combination, ABC assumes an unfunded loan commitment that it cannot cancel. ABC determines the fair value of the commitment to be a liability of $30,000 and recognizes that amount in applying acquisition accounting.

Separately, in applying Subtopic 326-20, ABC estimates the liability for off-balance sheet credit losses related to the loan commitment to be $25,000. ABC records a liability for off-balance sheet credit losses for that amount through earnings.

As a result, ABC's financial statements reflect the following amounts after the business combination related to the unfunded loan commitment.

| Account | Amount |
|---|---|
| **Balance sheet – liabilities** | |
| Commitment to extend credit | 30,000 |
| Liability for off-balance sheet credit losses | 25,000 |
| **Income statement** | |
| Credit loss expense | 25,000 |

Subsequently, ABC accounts for the commitment to extend credit (i.e. commitment fee) based on the guidance on Subtopic 310-20. Further, it accounts for the liability for off-balance sheet credit losses based on the guidance in Subtopic 326-20 – i.e. with changes in its estimate of expected credit losses recognized in earnings.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 12A.2.60** Do the PCD asset and PSL accounting models apply to assets acquired in a business combination?#

### Excerpt from ASC 805-20

• > Assets with Uncertain Cash Flows (Valuation Allowance)

**30-4** The acquirer shall not recognize a separate valuation allowance as of the **acquisition date** for assets acquired in a business combination that are measured at their acquisition-date fair values because the effects of uncertainty about future cash flows are included in the fair value measure, unless the assets acquired are financial assets for which the acquirer shall refer to the guidance in paragraphs 805-20-30-4A through 30-4B.

**30-4A** For acquired financial assets that are not **purchased financial assets with credit deterioration** or **purchased seasoned loans**, the acquirer shall record acquired financial assets at the acquisition-date fair value. Additionally, for these financial assets within the scope of Topic 326, an allowance shall be recorded with a corresponding charge to credit loss expense as of the reporting date.

**30-4B** For assets accounted for as purchased financial assets with credit deterioration (which includes beneficial interests that meet the criteria in paragraph 325-40-30-1A) and purchased seasoned loans, an acquirer shall recognize an allowance in accordance with Topic 326 with a corresponding increase to the amortized cost basis of the financial asset(s) as of the acquisition date.

• > Purchased Financial Assets with Credit Deterioration and Purchased Seasoned Loans

**30-26** An acquirer shall recognize **purchased financial assets with credit deterioration** (including beneficial interests meeting the conditions in paragraph 325-40-30-1A) and **purchased seasoned loans** in accordance with Section 326-20-30 for financial instruments measured at amortized cost or Section 326-30-30 for available-for-sale debt securities. Paragraphs 326-20-55-57 through 55-78 illustrate how the guidance is applied for purchased financial assets with credit deterioration measured at amortized cost. Paragraphs 326-30-55-5 through 55-7 illustrate how the guidance is applied to available-for-sale debt securities. An acquirer shall not accrete into interest income the credit losses embedded in the purchase price for purchased financial assets with credit deterioration and purchased seasoned loans.

**Interpretive response:** Yes. PCD asset accounting is applied if, on the acquisition date of the business combination or asset acquisition, the asset has experienced a more-than-insignificant deterioration in credit quality since origination or issuance. Further, PSL accounting is applied when a non-PCD loan that is subject to the PSL guidance is obtained through a business combination accounted for using the acquisition method in accordance with Subtopic 805-20. See section 12.2 for additional guidance on the scope of PCD assets and PSLs.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

If PCD or PSL accounting applies, the acquired PCD assets or PSLs are grossed up for the acquirer's initial estimate of expected credit losses. Due to the gross-up, the Day 1 expected credit losses do not result in acquisition accounting adjustments impacting goodwill. [805-20-30-4B]

For non-PCD assets acquired in a business combination that are also not PSLs, the assets are not grossed up. Instead, the estimate of expected credit losses is recorded in net income on the acquisition date. [805-20-30-4A]

## **Example 12A.2.20** Acquisition of bank with PCD assets

Bank ABC acquires Bank DEF in a business combination, paying $1,500,000.

The following are the fair values of the assets acquired and liabilities assumed. In this example, deferred income taxes are ignored.

| | |
|---|---|
| Cash: | 1,000,000 |
| Loans: | 2,000,000 |
| Land, building, furniture and equipment: | 1,100,000 |
| Core deposit intangibles: | 350,000 |
| Deposit liabilities: | (3,840,000) |

ABC determines that the entire portfolio consists of loans that have experienced a more-than-insignificant deterioration in credit quality since origination. In applying PCD accounting to these loans, it uses a method other than a discounted cash flow method (e.g. loss-rate method) to estimate the credit losses in the portfolio.

ABC determines the following amounts for the loans and related allowance:

- Total remaining unpaid principal balance: $3,000,000
- Total contractual principal cash flows that it expects to collect: $2,500,000
- Allowance for credit losses based on the unpaid principal balance (par amount): $350,000
- Non-credit discount: $650,000.

ABC records the following journal entry to account for the acquisition of DEF.

| | **Debit** | **Credit** |
|---|---|---|
| Cash (acquired) | 1,000,000 | |
| Loans[1] | 2,350,000 | |
| Land, building, furniture, equipment | 1,100,000 | |
| Core deposit intangibles | 350,000 | |
| Goodwill | 890,000 | |
| Deposit liabilities | | 3,840,000 |
| Cash (consideration) | | 1,500,000 |
| Allowance for credit losses | | 350,000 |
| *To record acquisition of DEF.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Note:

1. The loans are recorded at their initial amortized cost basis, which is calculated as fair value ($2,000,000) + the allowance for credit losses ($350,000). The loan balance is increased for the initial estimate of expected credit losses because the loans are PCD assets. This amount is net of the non-credit discount of $650,000.

## **Example 12A.2.30** Acquisition of bank with assets that are not PCD#

Bank ABC acquires Bank DEF in a business combination, paying $8,000,000.

The following are the fair values of the assets acquired and liabilities assumed. In this example, deferred income taxes are ignored.

| | |
|---|---|
| Cash: | 2,000,000 |
| Loans: | 25,000,000 |
| Land, building, furniture and equipment: | 3,100,000 |
| Core deposit intangibles: | 350,000 |
| Deposit liabilities: | (23,840,000) |

ABC determines that the entire portfolio consists of loans that have not experienced a more-than-insignificant deterioration in credit quality since origination.

***Scenario 1: All loans are PSLs***

In this scenario, the loan portfolio consists solely of loans that are subject to the PSL guidance (i.e. none are credit cards, debt securities or trade receivables). Since no loans are PCD, the entire loan portfolio consists of PSLs. In applying PSL accounting to these loans, ABC uses a method other than a discounted cash flow method (e.g. loss-rate method) to estimate the credit losses.

ABC determines the following amounts for the loans and related allowance.

- Total remaining unpaid principal balance: $27,000,000
- Total contractual principal cash flows that it expects to collect: $26,000,000
- Allowance for credit losses based on the unpaid principal balance (par amount): $1,000,000
- Non-credit discount: $1,000,000.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC records the following journal entry to account for the acquisition of DEF.

| | Debit | Credit |
|---|---|---|
| Cash (acquired) | 2,000,000 | |
| Loans[1] | 26,000,000 | |
| Land, building, furniture, equipment | 3,100,000 | |
| Core deposit intangibles | 350,000 | |
| Goodwill | 1,390,000 | |
| Deposit liabilities | | 23,840,000 |
| Cash (consideration) | | 8,000,000 |
| Allowance for credit losses (ACL) | | 1,000,000 |
| *To record acquisition of DEF.* | | |

Note:

1. The loans are recorded at their initial amortized cost basis, which is calculated as fair value ($25,000,000) + the allowance for credit losses ($1,000,000). The loan balance is increased for the initial estimate of expected credit losses because the loans are PSLs. This amount is net of the non-credit discount of $1,000,000. Subsequent measurement of the ACL for the loan portfolio may be based on the amortized cost basis if the entity elects to do so. See Question 12.4.10 for more details.

***Scenario 2: No loans are PSLs***

In this scenario, the loan portfolio consists solely of loans that are not subject to the PSL guidance. Therefore, gross-up accounting does not apply (i.e. no loans are PCD assets and none are PSLs). ABC uses a method other than a discounted cash flow method (e.g. loss-rate method) to estimate the credit losses.

ABC records the following journal entry to account for the acquisition of DEF.

| | Debit | Credit |
|---|---|---|
| Cash (acquired) | 2,000,000 | |
| Loans[1] | 25,000,000 | |
| Land, building, furniture, equipment | 3,100,000 | |
| Core deposit intangibles | 350,000 | |
| Goodwill | 1,390,000 | |
| Deposit liabilities | | 23,840,000 |
| Cash (consideration) | | 8,000,000 |
| *To record acquisition of DEF.* | | |

Note:

1. The loans are recorded net of premiums and discounts, if any.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC's initial estimate of expected credit losses for the loans is $600,000.

Because it is not applying gross-up accounting, ABC recognizes its initial estimate of expected credit losses on the acquired loans through net income.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 600,000 | |
| Allowance for credit losses | | 600,000 |
| *To record estimate of expected credit losses on loans that are not PCD assets and not PSLs.* | | |

## **Question 12A.2.70** Does an acquirer/purchaser apply PCD accounting to financial assets previously written off by the acquiree/seller?

**Interpretive response:** It depends. We believe the acquirer/purchaser should apply PCD accounting to financial assets previously written off by the acquiree/seller if the acquirer/purchaser has the contractual right to cash flows at the acquisition date. In contrast, PCD accounting would not apply if, for example, a loan was acquired through a business combination and the borrower had been previously discharged of its obligation by either the acquired entity or a court of law. In this case, the instrument would no longer be a financial asset.

## **Question 12A.2.80** Do the PCD asset and PSL accounting models apply to off-balance sheet credit exposures assumed in a business combination?#

**Interpretive response:** No. The PCD asset and PSL accounting models apply only to acquired assets, while an assumed off-balance sheet credit exposure is required to be recorded as a liability. As a result, PCD asset and PSL accounting should not be applied to off-balance sheet credit exposures, such as loan commitments or standby letters of credit, assumed in a business combination (see also Question 12A.2.50). [326-20 Glossary, 326-20-30-11, 30-13]

## **Question 12A.2.90** If pushdown accounting is elected, is PCD asset and PSL accounting at the parent level pushed down in the stand-alone financial statements of the acquiree?#

**Interpretive response:** Yes. If the acquired entity elects to apply pushdown accounting, PCD asset and PSL accounting at the parent level is pushed down in the acquired entity's stand-alone financial statements.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

In applying pushdown accounting, the carrying amounts of the assets and liabilities in the financial statements of the acquired entity are adjusted to reflect the acquisition accounting adjustments recorded (or that would have been recorded) in the consolidated financial statements of the parent entity as of the date control was obtained. [805-50-25-4, 30-10, 35-2]

If pushdown accounting is applied, the separate financial statements of the acquired entity must reflect all of the acquisition adjustments; partial pushdown accounting is not permitted. [805-50-25-4, 30-10, 35-2]

## 12A.3 Measurement period considerations for a business combination

### Excerpt from ASC 805-10

> The Measurement Period

**25-13** If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, in accordance with paragraph 805-10-25-17, the acquirer shall adjust the provisional amounts recognized at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date that, if known, would have affected the measurement of the amounts recognized as of that date.

**25-14** During the measurement period, the acquirer also shall recognize additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date that, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

**25-19** After the measurement period ends, the acquirer shall revise the accounting for a business combination only to correct an error in accordance with Topic 250.

There may be business combinations in which the information necessary to enable an acquirer to complete the identification and measurement of assets acquired and liabilities assumed is unavailable for a period of time following the acquisition date. In addition, if a business combination is consummated shortly before the acquirer's reporting date or the acquiree's operations are extensive or unusually complex, the acquirer may require additional time to obtain all of the data required to complete the acquisition accounting.

In these cases, the acquirer reports provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer is provided a reasonable period of time to obtain the information necessary to

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

enable it to complete the accounting for a business combination. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period cannot exceed one year from the acquisition date. There is no measurement period for an acquisition of assets that does not constitute a business combination. [805-10-25-13 – 25-14]

## **Question 12A.3.10** During the measurement period, can an acquirer reevaluate and change assets to which PCD asset accounting or PSL accounting is applied?#

**Background:** PCD accounting applies to acquired individual financial assets – or acquired groups of financial assets with similar risk characteristics – that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination or issuance, as determined by the acquirer's assessment. PSL accounting applies to acquired non-PCD loans that are not excluded from the scope of PSL accounting (see section 12.2.20).

**Interpretive response:** It depends. We believe an acquirer generally will have the information at the acquisition date to determine whether an asset is a PCD asset, and that the PCD criteria were intended to be applied in the reporting period that includes the business combination. Further, any asset determined not to be PCD is required to be accounted for using PSL accounting if it is a loan that is not excluded from the PSL accounting guidance.

### *PCD asset accounting*

From a practical perspective, the FASB concluded that it was unrealistic to expect that an entity could individually measure credit losses for each purchased financial asset within the reporting deadlines to determine whether each individually qualifies as PCD. Therefore, to facilitate meeting their reporting deadlines, the FASB provided entities with the ability to assess whether groups of financial assets with similar risk characteristics qualify as having experienced a more than insignificant deterioration in credit quality since origination, as opposed to requiring an assessment at the individual asset level. [ASU 2016-13.BC89]

In most cases, we believe an acquirer will have the information necessary to make its assessment in the first reporting period that includes the acquisition date and that the measurement period would not be extended solely to provide the acquirer with additional time to assess that information. As a result, the measurement period for PCD accounting should generally not extend beyond that first reporting date. For example, if an acquirer intends to evaluate whether assets have more-than-insignificant credit deterioration based solely on a comparison of credit metrics at origination and acquisition, and those credit metrics are available internally during the first reporting period that includes the business combination, we generally would expect that the measurement period would not extend beyond the first reporting period.

In contrast, there may be limited circumstances in which the acquirer in a business combination has not yet obtained the information required for its

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

assessment, such as third-party appraisals. In these cases, the acquirer should make a provisional assessment based on available information in the first reporting period that includes the business combination, and complete its assessment once the new information has been obtained (subject to limitations on the length of the measurement period). Any accounting changes resulting from changes in the determination of which assets meet the PCD criteria are recognized in the period in which the new information is obtained. [805-10-25-13 – 25-18]

After the measurement period is closed, if the acquirer obtains information that indicates that its previous determinations of which assets met the PCD criteria at the acquisition date were not correct, any changes in the assessment of which assets were credit deteriorated at acquisition are not a measurement period adjustment. Instead, the acquirer applies the guidance on error corrections in Topic 250; see chapter 4 of KPMG Handbook, Accounting changes and error corrections.

***PSL accounting***

If a loan (other than a credit card, debt security, or trade receivable arising from a transaction accounted for under Topic 606) is acquired in a business combination and is not PCD, it falls within the scope of the PSL guidance; therefore, no additional analysis is required to determine whether gross-up accounting applies. As a result, we believe an acquirer will have the information necessary to make this determination in the first reporting period that includes the acquisition date. After that initial period, if a loan originally designated as PCD is determined to not be (or vice versa), the loan will move into (or out of) the PSL category.

## **Example 12A.3.10** Applying the measurement period guidance to purchased financial assets#

Bank ABC, a calendar year reporting entity, acquires Bank DEF in a business combination on March 1, Year 1. DEF's assets include a portfolio of 100 loans all of which are collateralized. The loan portfolio consists solely of loans that are not subject to the PSL accounting guidance.

ABC concludes that its determination of whether each loan in the portfolio has more-than-insignificant deterioration in credit quality since origination depends, in part, on the fair value of the collateral at the acquisition date. (Question 4.2.30 discusses whether potential changes in collateral values are included in the estimate of expected credit losses.)

ABC places an order for this appraisal information from a third party, but it does not receive the information from the third party by the time it issues its Year 1 first quarter financial statements.

For purposes of those first quarter financial statements, ABC performs a provisional assessment using the information available at the time that compares the credit quality of each loan at the acquisition date and the origination date to determine whether there is a more-than-insignificant deterioration in credit quality since origination. Based on information available at the date the first quarter financial statements are issued, ABC determines there

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

has not been a more-than-insignificant deterioration in credit quality in any of the loans since origination. Therefore, it does not apply PCD accounting to such loans in those financial statements and provides the necessary measurement period disclosures related to this provisional assessment.

ABC receives the appraisal information from the third party on June 15, Year 1, and finalizes its assessment using that information. ABC's finalized assessment is that, because of lower-than-expected collateral values, 5 of the 100 loans experienced a more-than-insignificant deterioration in credit quality from origination to the acquisition date.

Based on ABC's final assessment, it changes 5 loans from non-PCD to PCD and records the necessary adjustment in its Year 1 second quarter financial statements. ABC also discloses in the notes to the financial statements the impact of the measurement period adjustment.

## **Question 12A.3.20** How are measurement period adjustments related to PCD assets accounted for?#

**Interpretive response:** We believe there are two types of adjustments related to acquired financial assets that may be made during the measurement period when the acquirer obtains additional information about facts and circumstances that existed as of the acquisition date:

- moving assets between non-PCD and PCD (see Question 12A.3.10); and
- changing the allowance for credit losses for PCD assets.

We believe the above adjustments should be reflected as indicated in the following table. For simplicity, the table ignores the impact on interest income as a result of the change in the amortized cost basis of the asset and income taxes.

| Type of adjustment | Impact |
|---|---|
| Moving assets (other than loans subject to PSL accounting) from non-PCD to PCD (without a change in the amount of the related allowance). | Increase the amortized cost basis with a corresponding decrease to credit loss expense. |
| Moving assets (other than loans subject to PSL accounting) from PCD to non-PCD (without a change in the amount of the related allowance). | Decrease the amortized cost basis with a corresponding increase to credit loss expense. |
| Moving assets from PCD to PSL, or from PSL to PCD (without a change in the amount of the related allowance). | No impact |
| Changing the amount of the allowance for credit losses recognized at the date of acquisition for PCD or PSL assets. | Adjust the allowance for credit losses with a corresponding adjustment to the amortized cost basis of the PCD asset. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 13. Off-balance sheet credit exposures

## Detailed contents

Item significantly updated in this edition: #

**13.1 How the standard works**

**13.2 Scope**

13.2.10 Overview

**Questions**

**Question 13.2.10** Is a loan commitment for a nonmortgage loan in the scope of Subtopic 326-20 if the loan will be held-for-sale upon funding?

**Question 13.2.20** Is a forward commitment to purchase loans in the scope of Subtopic 326-20?#

**13.3 Measurement**

13.3.10 Overview

**Questions**

**Question 13.3.10** When a loan commitment is unconditionally cancellable, does an entity consider its previous loss experience related to these types of loan commitments?

**Question 13.3.20** What is the contractual term used for estimating expected credit losses for loan commitments?

**Question 13.3.30** [Not used]

**Question 13.3.40** [Not used]

**Question 13.3.45** How does an entity account for the acquisition of a partially funded, noncancellable line of credit that relates to a funded PCD loan?

**Question 13.3.50** How does an entity account for the drawdown of a noncancellable line of credit that was partially funded and PCD at acquisition?

**Question 13.3.60** How does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans?#

**Question 13.3.70** When does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans that have not been specifically identified?#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Examples

**Example 13.3.05** Credit card portfolio with balances that fluctuate seasonally

**Example 13.3.10** Contractual term

**Example 13.3.20** Irrevocable loan commitment

**Example 13.3.30** Revocable loan commitment

**Example 13.3.40** [Not used]

**Example 13.3.50** Forward commitment to purchase loans that are not PCD and not PSLs#

**Example 13.3.60** Forward commitment to purchase PCD assets

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 13.1 How the standard works

The expected credit loss model under Subtopic 326-20 applies to off-balance sheet credit exposures such as unfunded loan commitments and standby letters of credit.

A liability for expected credit losses for off-balance sheet credit exposures is recognized if both of the following conditions are met:

- the entity has a present contractual obligation to extend the credit; and
- the obligation is not unconditionally cancellable by the entity.

Loan commitments may have a funded and an unfunded portion.

| Portion | Accounting |
|---|---|
| **Funded portion** | Expected credit losses are estimated under the same guidance used for estimating expected credit losses for other financial assets in the scope of Subtopic 326-20.<br>The expected credit losses for funded portions are reported in an allowance for credit losses. |
| **Unfunded portion of loan commitments that are not unconditionally cancellable by the lender** | Expected credit losses are estimated over the contractual term of the loan that will be originated. Subtopic 326-20 requires the estimate of expected credit losses to consider both:<br>• the likelihood that funding will occur; and<br>• an estimate of expected credit losses on commitments expected to be funded.<br>The expected credit losses for unfunded portions are reported as a liability for off-balance sheet credit losses. |
| **Unfunded portion of loan commitments that are unconditionally cancellable by the lender** | An estimate of expected credit losses is not established. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 13.2 Scope

## 13.2.10 Overview

### Excerpt from ASC 326-20

> Instruments

**15-2** The guidance in this Subtopic applies to the following items: ...

c. Off-balance-sheet credit exposures not accounted for as insurance. Off-balance-sheet credit exposure refers to credit exposures on off-balance-sheet loan commitments, standby letters of credit, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815 on derivatives and hedging.

The expected credit loss model under Subtopic 326-20 applies to off-balance sheet credit exposures. The term 'off-balance sheet credit exposures' refers to credit exposures on off-balance sheet loan commitments, standby letters of credit, financial guarantees (not accounted for as insurance contracts or a derivative) and other similar instruments. [326-20-15-2(c)]

Subtopic 326-20 requires measurement of the risk of loss from credit-related events and not due to events related to other risks. [326-20-15-2(c), 326-20-55-81 – 55-82]

### **Question 13.2.10** Is a loan commitment for a nonmortgage loan in the scope of Subtopic 326-20 if the loan will be held-for-sale upon funding?

**Background:** When a loan commitment relates to the origination of a loan that will be held-for-sale, the issuer (i.e. the potential lender) accounts for the commitment at fair value if: [815-10-15-71, 825-10-15-4]

- the commitment relates to mortgage loans;
- the fair value option is elected; or
- fair value accounting is required based on industry-specific guidance – e.g. broker-dealer accounting.

If the loan commitment does not qualify for fair value accounting, US GAAP does not prescribe an accounting treatment. However, before the adoption of ASU 2016-13, two accounting policy alternatives were used in practice: record the loan commitment either (a) as a loss contingency under Subtopic 450-20 if a loss was probable and reasonably estimable, or (b) at the lower of cost or fair value.

**Interpretive response:** It depends. We believe that if an entity's accounting policy before adoption of ASU 2016-13 was to recognize and measure contingent losses related to the loan commitment under Subtopic 450-20, the entity should apply:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- Subtopic 326-20 upon adoption of ASU 2016-13 for off-balance sheet exposure; and
- Subtopic 450-20 for the contingent losses from non-credit risks.

Once the commitment has been funded and the loan is classified as held-for-sale, the off-balance sheet credit exposure on the loan commitment no longer exists and the associated held-for-sale loan is not in the scope of Subtopic 326-20 (see Question 2.2.40).

In contrast, if the entity's accounting policy was to recognize and measure a loan commitment at the lower of cost or fair value, we believe the loan commitment is not in the scope of Subtopic 326-20. An entity should continue to measure these loan commitments using the lower of cost or fair value after the adoption of ASU 2016-13.

### **Question 13.2.20** Is a forward commitment to purchase loans in the scope of Subtopic 326-20?#

**Interpretive response:** Yes. Similar to a loan commitment, we believe a forward commitment to purchase loans (including loans that are deemed PCD assets and PSLs[1]) represents an off-balance sheet credit exposure in the scope of Subtopic 326-20 if the forward: [326-20-30-11, 815-10-15-83]

- is not accounted for as a derivative under Topic 815; and
- is not unconditionally cancellable by the acquirer/purchaser.

Note:

1. A loan will not be deemed a PSL until an entity adopts ASU 2025-08. See section 25.3 regarding effective dates.

## 13.3 Measurement

### 13.3.10 Overview

#### Excerpt from ASC 326-20

• > Off-Balance-Sheet Credit Exposures

**30-11** In estimating expected credit losses for off-balance-sheet credit exposures, an entity shall estimate expected credit losses on the basis of the guidance in this Subtopic over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the issuer. At the reporting date, an entity shall record a liability for credit losses on off-balance-sheet credit exposures within the scope of this Subtopic. An entity shall report in net income (as a credit loss expense) the amount necessary to adjust the liability for credit losses for management's current estimate of expected credit losses on off-balance-sheet credit exposures. For that period of exposure, the estimate of expected credit losses should consider both the likelihood that

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

funding will occur (which may be affected by, for example, a material adverse change clause) and an estimate of expected credit losses on commitments expected to be funded over its estimated life. If an entity uses a discounted cash flow method to estimate expected credit losses on off-balance-sheet credit exposures, the discount rate used should be consistent with the guidance in Section 310-20-35.

> Reporting Changes in Expected Credit Losses

**35-3** An entity shall adjust at each reporting period its estimate of expected credit losses on off-balance-sheet credit exposures. An entity shall report in net income (as credit loss expense or a reversal of credit loss expense) the amount necessary to adjust the liability for credit losses for management's current estimate of expected credit losses on off-balance-sheet credit exposures at each reporting date.

An entity estimates a liability for expected credit losses for off-balance sheet credit exposures if it:

- has a present contractual obligation to extend the credit; and
- cannot unconditionally cancel the obligation. [326-20-30-11]

Therefore, a liability is recognized for off-balance sheet credit exposure such as a loan commitment when all or a portion of the loan is unfunded and the entity cannot unconditionally cancel the commitment. No liability is recognized for any unfunded portion that is unconditionally cancellable by the entity. [326-20-30-11]

If a loan commitment has a funded and an unfunded portion, an allowance for credit losses for the funded portion is estimated under the same guidance used for estimating expected credit losses for other financial assets (see chapters 4 to 8). The liability for credit losses for the unfunded portion of a loan commitment is determined by estimating the expected credit losses over the contractual term of the loan that will be originated. In estimating this liability, the entity considers both the likelihood that funding will occur and the estimate of expected credit losses on commitments expected to be funded. [326-20-30-11]

At each reporting date, the liability is adjusted for management's current estimate of expected credit losses. Any changes in the estimate are immediately recognized in net income as credit loss expense or reversal of credit loss expense. [326-20-35-3]

## **Question 13.3.10** When a loan commitment is unconditionally cancellable, does an entity consider its previous loss experience related to these types of loan commitments?

**Interpretive response:** No, in relation to the unfunded portion; yes, in relation to the funded portion.

Because the commitment is unconditionally cancellable, an entity does not estimate expected credit losses for the unfunded portion. Therefore, we believe an entity should not estimate expected credit losses for the unfunded portion of a loan commitment that is unconditionally cancellable – even if it has a history

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

of incurring losses on additional amounts funded before loan commitments were cancelled. Similarly, we do not believe that an entity's history of not exercising its unconditional right to cancel in the past is relevant. In these instances, only after a loan commitment is funded does the entity recognize an allowance for credit losses for the funded portion.

An entity considers its historical loss experience when estimating the expected credit losses for the funded portion.

This answer is consistent with Example 10 from Subtopic 326-20, which indicates that a liability should not be recorded even though the entity has had a past practice of allowing drawdowns on credit cards before it has detected borrower defaults.

## Excerpt from ASC 326-20

• > Example 10: Application of Expected Credit Losses to Unconditionally Cancellable Loan Commitments

**55-54** This Example illustrates the application of the guidance in paragraph 326-20-30-11 for off-balance-sheet credit exposures that are unconditionally cancellable by the issuer.

**55-55** Bank M has a significant credit card portfolio, including funded balances on existing cards and unfunded commitments (available credit) on credit cards. Bank M's card holder agreements stipulate that the available credit may be unconditionally cancelled at any time.

**55-56** When determining the allowance for credit losses, Bank M estimates the expected credit losses over the remaining lives of the funded credit card loans. Bank M does not record an allowance for unfunded commitments on the unfunded credit cards because it has the ability to unconditionally cancel the available lines of credit. Even though Bank M has had a past practice of extending credit on credit cards before it has detected a borrower's default event, it does not have a present contractual obligation to extend credit. Therefore, an allowance for unfunded commitments should not be established because credit risk on commitments that are unconditionally cancellable by the issuer are not considered to be a liability.

## **Example 13.3.05** Credit card portfolio with balances that fluctuate seasonally

Bank has a portfolio of credit card accounts (i.e. revolving lines of credit). It can unconditionally cancel the unused portion of each credit card line of credit.

Bank is estimating its allowance for credit losses at the end of Q2. Its historical experience has demonstrated that the funded balances of the portfolio are higher during Q4 (related to the holiday shopping season) and lower during Q2 (after tax refunds are received).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Bank estimates expected credit losses only on the funded balances of these credit cards at the end of Q2. Because Bank can unconditionally cancel the unused portion, it does not recognize any amount of expected credit losses related to that unused portion even though it expects that funded balances will increase over the remainder of the year and that it will experience credit losses on certain of those additional future drawdowns.

Further, Bank does not make a qualitative adjustment that records expected credit losses related to those unfunded loan commitments.

## **Question 13.3.20** What is the contractual term used for estimating expected credit losses for loan commitments?

**Interpretive response:** Expected credit losses for loan commitments are estimated over the contractual term of the loan that will be originated. [326-20-30-11]

## **Example 13.3.10** Contractual term

Bank provides a 90-day $100,000 loan commitment. If funded, Bank would provide a 10-year loan. Bank determines the likelihood that the loan commitment will be drawn is 50% and the 10-year loan would have a probability of default of 2% and a loss given default of 40%.

Bank calculates its liability for off-balance sheet credit exposure as $100,000 × 2% (probability of default for a 10-year loan) × 40% (loss given default) × 50% (likelihood of funding) = $400.

## **Example 13.3.20** Irrevocable loan commitment

Bank provides a four-year $100,000 irrevocable loan commitment to Customer.

Bank uses a loss-rate method to determine its allowance for credit losses. It calculates a loss rate of 0.4% based on historical loss experience adjusted for asset-specific risk characteristics, current conditions and reasonable and supportable forecasts. Further, it determines the likelihood that the unfunded amount will be drawn is 50%.

At the end of Year 1, the funded amount is $60,000 and the unfunded amount is $40,000. Bank records the following journal entries.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 320 | |
| Allowance for credit losses[1] | | 240 |
| Liability for off-balance sheet credit losses[2] | | 80 |
| *To record expected credit losses for funded and unfunded loan commitment.* | | |

Notes:
1. $60,000 (funded portion) × 0.4% (loss rate) = $240.
2. $40,000 (unfunded portion) × 0.4% (loss rate) × 50% (likelihood that the unfunded amount will be drawn) = $80.

At the end of Year 1, Bank's financial statements reflect the following amounts.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Loans | 60,000 |
| Allowance for credit losses | (240) |
| **Balance sheet – liabilities** | |
| Liability for off-balance sheet credit losses | 80 |
| **Income statement** | |
| Credit loss expense | 320 |

Bank subsequently funds the remaining $40,000. At the end of Year 2, the funded amount is $100,000 and the unfunded amount is $0. Bank's loss rate remains unchanged.

| | Debit | Credit |
|---|---|---|
| Credit loss expense[1] | 80 | |
| Liability for off-balance sheet credit losses[2] | 80 | |
| Allowance for credit losses[3] | | 160 |
| *To record expected credit losses for unfunded amount that was funded.* | | |

Notes:
1. The difference between the additional allowance for credit losses recognized at the reporting date and the previously established liability for off-balance sheet credit losses.
2. Reversal of previously recognized liability as a result of the unfunded amount being funded.
3. $40,000 (additional funded portion) × 0.4% (loss rate) = $160.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

At the end of Year 2, Bank's financial statements reflect the following amounts.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Loans | 100,000 |
| Allowance for credit losses | (400) |
| **Income statement** | |
| Credit loss expense | 80 |

The drawdown of additional amounts on the loan commitment during Year 2 results in the following.

- **Increased credit loss expense.** This is because the same loss rate is applied to both the funded and unfunded portions but expected credit losses for unfunded amounts are adjusted for the likelihood that the unfunded amount will be drawn.
- **Reclassification of the liability** for off-balance sheet credit losses on the unfunded portion to the allowance for credit losses upon full funding of the loan.

## Example 13.3.30 Revocable loan commitment

Assume the same facts as in Example 13.3.20 (Year 1), except that Bank has the discretion to cancel the loan commitment at any time without providing advance notice to Customer.

At the end of Year 1, the funded amount is $60,000 and the unfunded amount is $40,000. Bank records the following journal entry for the funded portion.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 240 | |
| Allowance for credit losses[1] | | 240 |
| *To record expected credit losses for funded portion of revocable loan commitment.* | | |

Note:
1. $60,000 (funded portion) × 0.4% (loss rate) = $240.

For the unfunded portion, Bank does not calculate an estimate of expected credit losses because the loan commitment is unconditionally cancellable by Bank.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 13.3.45** How does an entity account for the acquisition of a partially funded, noncancellable line of credit that relates to a funded PCD loan?

**Background:** Entity purchases a loan that was partially funded at acquisition. The funded portion of the loan has experienced a more-than-insignificant deterioration in credit quality since origination.

**Interpretive response:** An entity separately considers the credit exposure on the funded and unfunded portions of a line of credit that is acquired. [326-20-30-11]

If the funded portion of the line of credit has experienced a more-than-insignificant deterioration in credit quality since origination, the entity recognizes an allowance for credit losses related to the funded PCD asset using the gross-up method (see section 12.3).

In contrast, the unfunded portion of the line of credit is not eligible for PCD accounting (see Question 12A.2.80). Therefore, the entity separately recognizes, through earnings, a liability related to the unfunded portion's off-balance sheet credit exposure. [326-20-30-13]

## **Question 13.3.50** How does an entity account for the drawdown of a noncancellable line of credit that was partially funded and PCD at acquisition?

**Interpretive response:** PCD accounting should not be applied to the undrawn (i.e. unfunded) line of credit (see Question 12A.2.80). However, we believe that as the line of credit is drawn down and the commitment is funded, the newly funded portion should be combined with the funded PCD asset because a funded loan is a single unit of account. Therefore, as a line of credit is drawn down, the entity reverses the related liability for off-balance sheet credit exposure, and it estimates and recognizes an allowance for credit losses for the entire funded loan.

## **Question 13.3.60** How does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans?#

**Background:** As discussed in Question 13.2.20, we believe a forward commitment to purchase loans is in the scope of Subtopic 326-20 if it is: [326-20-30-11, 815-10-15-83]

- not accounted for as a derivative under Topic 815; and
- not unconditionally cancellable by the acquirer/purchaser.

**Interpretive response:** We believe the recognition and measurement of the liability for credit losses related to a forward commitment to purchase loans depends on whether gross-up accounting applies to the acquired loan.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- **Gross-up accounting does *not* apply to the acquired loan:** For loans that are not PCD assets and not PSLs[1], the liability for credit losses and the related credit loss expense should be recognized at the inception of the commitment and determined by estimating the expected credit losses over the contractual term of the loan that will be purchased.
- **Gross-up accounting applies to the acquired loan:** For PCD assets and PSLs[1], there is no liability for credit losses recognized at the inception of the commitment. However, an entity should monitor cash flows expected to be collected from the underlying loans and assess whether a liability for credit losses and related credit loss expense should be recorded for adverse changes in expected cash flows since inception of the commitment.

For PCD assets and PSLs[1], we believe the entity's estimate of expected credit losses at the commitment date of the forward purchase contract should be recorded through a balance sheet gross-up entry when the underlying loans are acquired. This ensures consistency between purchases of PCD assets and PSLs[1] via a forward commitment and purchases of PCD assets and PSLs[1] without a forward commitment.

Because this amount will not be recognized in the income statement, we believe it should not be included in the measurement of the liability for off-balance sheet credit exposure.

Note:

1. A loan will not be deemed a PSL until an entity adopts ASU 2025-08. See section 25.3 regarding effective dates.

## **Example 13.3.50** Forward commitment to purchase loans that are not PCD and not PSLs#

On January 15, Year 1, Bank enters into a commitment to purchase newly-originated loans from a seller in 90 days at a fixed price. There is no consideration exchanged when the commitment is entered into. The commitment may not be unconditionally cancelled by Bank and does not meet the definition of a derivative because the net settlement characteristic is not met.

Bank determines that the loans to be purchased are not PCD assets because they have not experienced a more-than-insignificant deterioration in credit quality since their origination date and that they are not PSLs[1]. On January 15, Year 1, Bank's initial estimates for the loans to be purchased are as follows.

| | |
|---|---|
| Total amortized cost of loans to be purchased under the forward: | 100,000 |
| Allowance for credit losses based on amortized cost: | 2,000 |

For simplicity, this example assumes there is no change in the liability for off-balance sheet credit losses during the commitment period. Bank records the following journal entry at the commitment date.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 2,000 | |
| Liability for off-balance sheet credit loss | | 2,000 |
| *To record expected credit losses on forward commitment.* | | |

On April 15, Year 1, the $100,000 in loans are purchased for cash and Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Loans | 100,000 | |
| Liability for off-balance sheet credit loss | 2,000 | |
| Allowance for credit losses | | 2,000 |
| Cash | | 100,000 |
| *To record purchase of loans under forward commitment.* | | |

Note:

1. A loan will not be deemed a PSL until an entity adopts ASU 2025-08. See section 25.3 regarding effective dates.

## **Example 13.3.60** Forward commitment to purchase PCD assets

*Although this example is provided for PCD assets, similar approaches would be appropriate for the accounting for forward commitments to purchase PSLs.*

On January 15, Bank enters into a commitment to purchase loans from a seller in 90 days for $700,000. There is no consideration exchanged when the commitment is entered into. The commitment may not be unconditionally cancelled by Bank and does not meet the definition of a derivative because the net settlement characteristic is not met.

Bank determines that the loans to be purchased have experienced a more-than-insignificant deterioration in credit quality since their origination date. Therefore, Bank concludes that it will account for the loans under the guidance for PCD assets at the date of acquisition.

On January 15, Bank's initial estimates for the loans to be purchased are as follows.

| | |
|---|---|
| Total face amount (face value): | 1,000,000 |
| Total contractual principal cash flows that it expects to collect: | 800,000 |
| Allowance for credit losses based on unpaid principal balance (par): | 200,000 |
| Non-credit discount: | 100,000 |

During the 90-day commitment period (January 15 to April 15), Bank monitors cash flows expected to be collected from the underlying loans. On March 31,

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Bank determines that expected cash flows decreased by $50,000 to $750,000, which requires Bank to record the following journal entry.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 50,000 | |
| Liability for off-balance sheet credit loss | | 50,000 |
| *To record expected credit losses on forward commitment.* | | |

On April 15, the loans are purchased for cash and Bank records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Loans | 1,000,000 | |
| Liability for off-balance sheet credit loss | 50,000 | |
| Cash | | 700,000 |
| Allowance for credit losses | | 250,000 |
| Loans – non-credit discount | | 100,000 |
| *To record purchase of loans under forward commitment.* | | |

## **Question 13.3.70** When does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans that have not been specifically identified?#

**Background:** As discussed in Question 13.2.20, we believe a forward commitment to purchase loans is in the scope of Subtopic 326-20 if it is: [326-20-30-11, 815-10-15-83]

- not accounted for as a derivative under Topic 815; and
- not unconditionally cancellable by the acquirer/purchaser.

**Interpretive response:** We believe the liability for off-balance sheet credit exposure should be recognized when the forward commitment is entered into even if the loans are not specifically identified.

Generally, these forward commitments include specific criteria/guidelines related to the type and quality of loans to be purchased. Before identifying the specific loan, the acquirer/purchaser should use these criteria/guidelines to estimate which loans will be PCD or PSLs[1] and to estimate the expected credit losses on the loans that will be later identified and delivered.

Note:

1. A loan will not be deemed a PSL until an entity adopts ASU 2025-08. See section 25.3 regarding effective dates.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 14. Guarantees

## Detailed contents

**14.1 How the standard works**

**14.2 Guarantees subject to Subtopic 326-20**

14.2.10 Overview

**Question**

**Question 14.2.10** What type of guarantees are in the scope of Subtopic 326-20?

**14.3 Initial recognition and measurement**

14.3.10 Overview

**Examples**

**Example 14.3.10** Financial standby letter of credit: up-front cash premium

**Example 14.3.20** Financial standby letter of credit: premium receivable

**14.4 Subsequent measurement**

14.4.10 Overview

14.4.20 Non-contingent aspect (stand-ready obligation)

14.4.30 Contingent aspect

**Example**

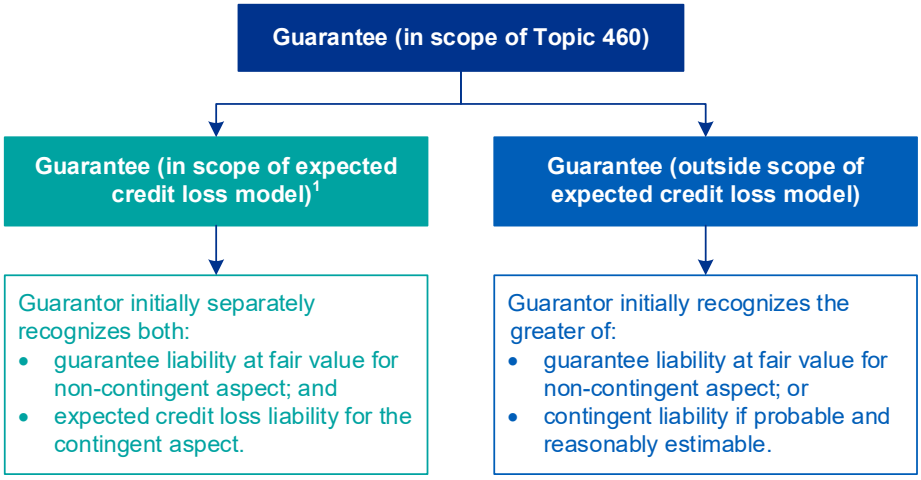
**Example 14.4.10** Accounting for a default put option

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 14.1 How the standard works

Guarantees in the scope of Topic 460 that create off-balance sheet credit exposure for the guarantor are also in the scope of Subtopic 326-20.

The contingent aspect of these guarantees is accounted for separately from the guarantee liability (non-contingent stand-ready aspect) accounted for under Topic 460. Subtopic 326-20's expected credit loss model is applied to the contingent aspect.




Note:

1. Guarantees that create off-balance sheet credit exposure are in the scope of Subtopic 326-20.

This chapter addresses only the accounting by the guarantor (the issuer).

The following table summarizes the initial and subsequent measurement guidance applicable to guarantees in the scope of Topic 460 that are also in the scope of Subtopic 326-20.

| Initial measurement | Subsequent measurement |
|---|---|
| **Non-contingent stand-ready component** | |
| **Fair value is recognized as a liability.** | Typically the liability is reduced through net income as the guarantor is released from its obligation.<br>Three methods are used in practice to recognize the liability in net income:<br>• in full upon either expiration or settlement of the guarantee;<br>• systematic and rational amortization method; or<br>• changes in the fair value of the guarantee. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Initial measurement | Subsequent measurement |
|---|---|
| **Contingent component** | |
| **Expected credit losses are estimated under Subtopic 326-20 and are recognized as a separate liability.** | At each reporting date, expected credit losses are estimated and related adjustments to the liability are made through net income. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 14.2 Guarantees subject to Subtopic 326-20

### 14.2.10 Overview

The guidance in Subtopic 326-20 applies to a subset of the guarantees that are in the scope of Topic 460. Only guarantees that create off-balance sheet credit exposure for the guarantor are in the scope of Subtopic 326-20. Examples of guarantees that create off-balance sheet credit exposure include financial standby letters of credit and other types of guarantees that relate to the non-payment of a financial obligation – e.g. a borrower's obligation under a loan or debt security. [460-10-15-4, 326-20-15-2(c)]

#### **Question 14.2.10** What type of guarantees are in the scope of Subtopic 326-20?

**Interpretive response:** Guarantees that create off-balance sheet credit exposure, but are not accounted for as either derivatives or insurance, are in the scope of Subtopic 326-20. We believe that guarantees create off-balance sheet credit exposure if they require the guarantor to make a payment due to a failure of another party to satisfy its required payment obligation.

Guarantees that may be in the scope of Subtopic 326-20 include:

- a franchisor's guarantee of a franchisee's lease obligation;
- a standby letter of credit issued by a financial institution;
- an investor's guarantee of an investee's debt obligation; and
- a manufacturer's guarantee of a customer loan used to finance the purchase of goods from the manufacturer.

However, a guarantee of an entity's own performance or its own obligation, including a parent's guarantee of the performance of a consolidated subsidiary (from the perspective of the consolidated financial statements), is not in the scope of Subtopic 326-20.

## 14.3 Initial recognition and measurement

### 14.3.10 Overview

#### Excerpt from ASC 460-10

**General**

**25-2** The issuance of a guarantee obligates the guarantor (the issuer) in two respects:

a. The guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur (the noncontingent aspect).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

b. The guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur (the contingent aspect).

For guarantees that are not within the scope of Subtopic 326-20 on financial instruments measured at amortized cost, no bifurcation and no separate accounting for the contingent and noncontingent aspects of the guarantee are required by this Topic. For guarantees that are within the scope of Subtopic 326-20, the expected credit losses (the contingent aspect) shall be measured and accounted for in addition to and separately from the fair value of the guarantee (the noncontingent aspect) in accordance with paragraph 460-10-30-5.

**25-3** Because the issuance of a guarantee imposes a noncontingent obligation to stand ready to perform in the event that the specified triggering events or conditions occur, the provisions of Section 450-20-25 regarding a guarantor's contingent obligation under a guarantee should not be interpreted as prohibiting a guarantor from initially recognizing a liability for a guarantee even though it is not **probable** that payments will be required under that guarantee. Similarly, for guarantees within the scope of Subtopic 326-20, the requirement to measure a guarantor's expected credit loss on the guarantee should not be interpreted as prohibiting a guarantor from initially recognizing a liability for the noncontingent aspect of a guarantee.

**25-4** At the inception of a guarantee, a guarantor shall recognize in its statement of financial position a liability for that guarantee. This Subsection does not prescribe a specific account for the guarantor's offsetting entry when it recognizes a liability at the inception of a guarantee. That offsetting entry depends on the circumstances in which the guarantee was issued. See paragraph 460-10-55-23 for implementation guidance.

> Fair Value Objective

**30-2** Except as indicated in paragraphs 460-10-30-3 through 30-5, the objective of the initial measurement of a guarantee liability is the fair value of the guarantee at its inception. For example:

a. If a guarantee is issued in a standalone arm's-length transaction with an unrelated party, the liability recognized at the inception of the guarantee shall be the premium received or receivable by the guarantor as a practical expedient.
b. If a guarantee is issued as part of a transaction with multiple elements with an unrelated party (such as in conjunction with selling an asset), the liability recognized at the inception of the guarantee should be an estimate of the guarantee's fair value. In that circumstance, a guarantor shall consider what premium would be required by the guarantor to issue the same guarantee in a standalone arm's-length transaction with an unrelated party as a practical expedient.
c. If a guarantee is issued as a contribution to an unrelated party, the liability recognized at the inception of the guarantee shall be measured at its fair value, consistent with the requirement to measure the contribution made at fair value, as prescribed in Section 720-25-30. For related implementation guidance, see paragraph 460-10-55-14.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

> Guarantees within the Scope of Subtopic 326-20

**30-5** At the inception of a guarantee within the scope of Subtopic 326-20 on financial instruments measured at amortized cost, the guarantor is required to recognize both of the following as liabilities:

a. The amount that satisfies the fair value objective in accordance with paragraph 460-10-30-2
b. The contingent liability related to the expected credit loss for the guarantee measured under Subtopic 326-20.

**General**

**45-1** Paragraph 326-20-45-2 states that an accrual for credit loss on a financial instrument with off-balance-sheet risk (including financial guarantees and **financial standby letters of credit**) shall be a liability that is recorded separate from a valuation account related to a recognized financial instrument.

A guarantee in the scope of Subtopic 326-20 consists of two components, one of which is recognized and measured under Topic 460 and the other under Subtopic 326-20. These two components are: [460-10-25-2]

- a *non-contingent* obligation to stand ready to perform – i.e. the stand-ready obligation; and
- a *contingent* obligation to make future payments if specific conditions occur.

## *Non-contingent stand-ready obligation*

A liability for the non-contingent obligation of a guarantee is recognized under Topic 460 at fair value at inception. The fair value of a guarantee inherently includes a market participant's assumptions regarding credit risk in the guarantee. [460-10-25-3, 30-5]

## *Contingent obligation*

A separate liability for off-balance sheet credit risk is recognized under Subtopic 326-20 for expected credit losses related to the contingent obligation. The FASB decided that this approach was necessary to appropriately present expected credit losses on guarantees without affecting the fee recognition that results from the accounting for the non-contingent obligation. [460-10-25-3, 30-5, ASU 2016-13.BC97]

There are two aspects of the guarantor's estimation of expected credit losses for the contingent obligation:

- the likelihood that the guarantor will have to fulfill the obligation; and
- an estimate of expected credit losses on the obligation.

The estimate of expected credit losses on the obligation considers the attributes of the guarantee. For example, an issuer of a financial standby letter of credit guarantees an obligor's payment to a third party. The issuer considers any recourse it may have to the obligor when estimating the expected credit losses on its obligation.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 14.3.10** Financial standby letter of credit: up-front cash premium

Exporter sells goods to Foreign Buyer and Foreign Buyer promises to pay within two years. Guarantor issues a stand-alone arm's-length $1,000,000 financial standby letter of credit to guarantee that Exporter will receive payment on time and in the correct amount if Foreign Buyer does not make payments to Exporter. Guarantor receives an up-front cash premium of $30,000.

In accordance with Topic 460, Guarantor determines that the fair value of the financial guarantee liability recognized at inception is the premium received. This is because the guarantee was issued in a stand-alone arm's-length transaction.

Guarantor estimates the expected credit loss for the financial guarantee to be $5,000.

It records the following journal entry to account for the guarantee at inception.

| | Debit | Credit |
|---|---|---|
| Cash | 30,000 | |
| Credit loss expense | 5,000 | |
| Financial guarantee liability – non-contingent | | 30,000 |
| Liability for off-balance sheet credit losses – contingent | | 5,000 |
| *To record fair value of financial guarantee (non-contingent aspect) and associated liability for off-balance sheet credit losses (contingent aspect).* | | |

## **Example 14.3.20** Financial standby letter of credit: premium receivable

Assume the same fact pattern as in Example 14.3.10 except that the premium of $30,000 is a receivable (cash not paid up-front).

In accordance with Topic 460, Guarantor determines that the fair value of the financial guarantee liability recognized at inception is the premium receivable. This is because the guarantee was issued in a stand-alone arm's-length transaction.

Guarantor estimates the expected credit loss for the financial guarantee to be $5,000, and the expected credit loss for the premium receivable to be $1,000.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

It records the following journal entry to account for the guarantee at inception.

| | Debit | Credit |
|---|---|---|
| Premium receivable | 30,000 | |
| Credit loss expense | 6,000 | |
| Financial guarantee liability – non-contingent | | 30,000 |
| Liability for off-balance sheet credit losses – contingent | | 5,000 |
| Allowance for credit losses – premium receivable | | 1,000 |
| *To record fair value of financial guarantee (non-contingent aspect) and associated liability for off-balance sheet credit losses (contingent aspect), and related premium receivable with associated allowance for credit losses.* | | |

## 14.4 Subsequent measurement

### 14.4.10 Overview

#### Excerpt from ASC 460-10

**General**

**35-1** This Subsection does not describe in detail how the guarantor's liability for its obligations under the guarantee would be measured after its initial recognition. The liability that the guarantor initially recognized under paragraph 460-10-25-4 would typically be reduced (by a credit to earnings) as the guarantor is released from risk under the guarantee.

**35-2** Depending on the nature of the guarantee, the guarantor's release from risk has typically been recognized over the term of the guarantee using one of the following three methods:

a. Only upon either expiration or settlement of the guarantee
b. By a systematic and rational amortization method
c. As the fair value of the guarantee changes.

Although those three methods are currently being used in practice for subsequent accounting, this Subsection does not provide comprehensive guidance regarding the circumstances in which each of those methods would be appropriate. A guarantor is not free to choose any of the three methods in deciding how the liability for its obligations under the guarantee is measured subsequent to the initial recognition of that liability. A guarantor shall not use fair value in subsequently accounting for the liability for its obligations under a previously issued guarantee unless the use of that method can be justified under generally accepted accounting principles (GAAP). For example, fair value

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

is used to subsequently measure guarantees accounted for as derivative instruments under Topic 815.

**35-4** The discussion in paragraph 460-10-35-2 about how a guarantor typically reduces the liability that it initially recognized does not encompass the recognition and subsequent adjustment of the contingent liability related to the contingent loss for the guarantee. The contingent aspect of the guarantee shall be accounted for in accordance with Subtopic 450-20 unless the guarantee is accounted for as a derivative instrument under Topic 815 or the guarantee is within the scope of Subtopic 326-20 on financial instruments measured at amortized cost. For guarantees within the scope of Subtopic 326-20, the expected credit losses (the contingent aspect) of the guarantee shall be accounted for in accordance with that Subtopic in addition to and separately from the fair value of the guarantee liability (the noncontingent aspect) accounted for in accordance with paragraph 460-10-30-5.

The subsequent measurement of the contingent and non-contingent components of guarantees within the scope of Subtopic 326-20 differ because the non-contingent portion is measured under Topic 460 and the contingent portion is measured under Subtopic 326-20.

## 14.4.20 Non-contingent aspect (stand-ready obligation)

Topic 460 does not prescribe accounting guidance for the non-contingent aspect of guarantees subsequent to initial recognition. Rather, it describes that the liability is typically reduced through net income as the guarantor is released from risk under the guarantee and identifies three methods used in practice for making that reduction:

- only in full upon either expiration or settlement of the guarantee;
- systematic and rational amortization method; or
- through changes in the fair value of the guarantee.

The selection of the appropriate method depends on the nature of the guarantee. Additionally, a liability cannot be subsequently measured at fair value unless fair value is required or permitted by other relevant guidance. [460-10-35-1 – 35-2]

We believe the selection of a method to account for the stand-ready obligation is an accounting policy election that should be followed consistently once it is selected.

## 14.4.30 Contingent aspect

Measurement of the guarantee liability for the contingent aspect of the guarantee is determined under Subtopic 326-20. At each reporting date, an entity estimates expected credit losses and adjusts the liability for off-balance sheet credit losses through net income. [460-10-35-4, 326-20-30-11]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 14.4.10** Accounting for a default put option

Bank (the transferor) originates a loan for its $100 par amount. On January 1, Year 1, Bank transfers the loan in a transaction that is accounted for as a sale. Bank receives cash of $115 from Purchaser (the transferee). In connection with the sale, Bank obligates itself to repurchase the loan for its unpaid principal balance if the loan defaults.

The repurchase arrangement is a financial guarantee in the scope of Subtopic 326-20 (see Question 2.2.90) and Topic 460. Therefore, a liability for the non-contingent (stand-ready) obligation is recognized under Topic 460 and a separate liability is recognized under Subtopic 326-20 for expected credit losses related to the contingent obligation.

The fair value of the repurchase arrangement is $8 on January 1, Year 1.

Bank measures the contingent component (i.e. liability for off-balance sheet credit exposure) based on the likelihood of the loan defaulting and the amount of loss Bank will incur in the event of a default. If a default occurs, a loss arises because the repurchase price equals the loan's unpaid principal balance, while the repurchased loan is required to be initially recognized at fair value. Bank estimates its liability for the off-balance sheet credit exposure related to the repurchase arrangement as $5 on January 1, Year 1.

For simplicity, journal entries pertaining to the subsequent measurement of the non-contingent liability are omitted from this example.

Bank records the following journal entries on January 1, Year 1.

| | Debit | Credit |
|---|---|---|
| Cash | 115 | |
| Financial guarantee liability (recourse arrangement) – non-contingent | | 8 |
| Loans | | 100 |
| Gain on sale of loans | | 7 |
| *To recognize sale of loan, including fair value of related financial guarantee (recourse arrangement).* | | |
| Credit loss expense | 5 | |
| Liability for off-balance sheet credit exposure (repurchase arrangement) – contingent | | 5 |
| *To recognize liability for off-balance sheet credit exposure (contingent aspect) associated with repurchase arrangement.* | | |

At the end of Year 1, when the loan's fair value is $80, the credit quality of the loan has deteriorated. Bank expects a loss of $20 related to its repurchase arrangement, which represents the loss Bank will have if the credit event occurs. Bank records the following journal entry.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Debit | Credit |
|---|---|---|
| Credit loss expense[1] | 15 | |
| Liability for off-balance sheet credit exposure (repurchase arrangement) – contingent | | 15 |
| *To record change in expected credit losses associated with repurchase arrangement.* | | |

Note:

1. Difference between the expected loss ($20) and the liability for off-balance sheet credit exposure recorded on January 1, Year 1 ($5).

On January 1, Year 2, the borrower on the loan defaults and Bank repurchases the loan for its par amount of $100. At that date:

- The loan's fair value is $80.
- Bank determines that the loan meets the definition of PCD, because the borrower has defaulted since the loan was originated.
- Bank estimates credit losses for the loan using a non-discounted cash flow method. It expects to collect $87 of the $100 unpaid principal balance.

Bank records the following journal entries.

| | Debit | Credit |
|---|---|---|
| Loan[1] | 80 | |
| Liability for off-balance sheet credit exposure (repurchase arrangement) – contingent | 20 | |
| Cash | | 100 |
| *To record repurchase of loan pursuant to repurchase arrangement (financial guarantee).* | | |
| Loan | 20 | |
| Allowance for credit losses[2] | | 13 |
| Loan – non-credit discount[3] | | 7 |
| *To record gross-up entry for PCD loan determination.* | | |

Notes:

1. A transferor that regains control of a transferred financial asset initially measures the asset at its fair value. [860-20-30-3]
2. Difference between the par amount of the loan ($100) and the cash flows expected to be collected ($87).
3. Difference between the cash flows expected to be collected ($87) and the loan's fair value ($80).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 15. Other investments in equity method investees

## Detailed contents

**15.1 How the standard works**

**15.2 Allocating equity method investment losses to additional investments**

15.2.10 Overview

**Question**

**Question 15.2.10** Is an additional investment's allowance for credit losses estimated before or after allocating equity method losses?

**Example**

**Example 15.2.10** Interaction of Subtopic 326-20 and Subtopic 323-10

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 15.1 How the standard works

This chapter illustrates the interaction between Topic 326 and Subtopic 323-10 regarding equity method investments.

This interaction occurs when an entity (investor) holding an equity method investment provides additional financial support through financial assets subject to Topic 326 – e.g. a loan to the investee or an investment in debt securities issued by the investee.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 15.2 Allocating equity method investment losses to additional investments

## 15.2.10 Overview

### Excerpt from ASC 323-10

> Equity Method Losses

**35-19** An investor's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by the equity method plus advances made by the investor. An equity method investor shall continue to report losses up to the investor's investment carrying amount, including any additional financial support made or committed to by the investor. Additional financial support made or committed to by the investor may take the form of any of the following:

a. Capital contributions to the investee
b. Investments in additional common stock of the investee
c. Investments in preferred stock of the investee
d. Loans to the investee
e. Investments in debt securities (including mandatorily redeemable preferred stock) of the investee
f. Advances to the investee.

See paragraphs 323-10-35-24 and 323-10-35-28 for additional guidance if the investor has other investments in the investee.

**35-20** The investor ordinarily shall discontinue applying the equity method if the investment (and net advances) is reduced to zero and shall not provide for additional losses unless the investor has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee.

**35-21** An investor shall, however, provide for additional losses if the imminent return to profitable operations by an investee appears to be assured. For example, a material, nonrecurring loss of an isolated nature may reduce an investment below zero even though the underlying profitable operating pattern of an investee is unimpaired.

**35-22** If the investee subsequently reports net income, the investor shall resume applying the equity method only after its share of that net income equals the share of net losses not recognized during the period the equity method was suspended.

• > Investee Losses If the Investor Has Other Investments in the Investee

**35-23** The guidance in the following paragraph applies to situations in which both of the following conditions exist:

a. An investor is not required to advance additional funds to an investee.
b. Previous losses have reduced the common stock investment account to zero.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**35-24** In the circumstances described in the preceding paragraph, the investor shall continue to report its share of equity method losses in its statement of operations to the extent of and as an adjustment to the adjusted basis of the other investments in the investee. The order in which those equity method losses should be applied to the other investments shall follow the seniority of the other investments (that is, priority in liquidation). For each period, the adjusted basis of the other investments shall be adjusted for the equity method losses, then the investor shall apply Subtopic 310-10, 320-10, 321-10, 326-20, or 326-30 to the other investments, as applicable.

**35-25** The cost basis of the other investments is the original cost of those investments adjusted for the effects of write-downs, unrealized holding gains and losses on debt securities classified as trading in accordance with Subtopic 320-10 or equity securities accounted for in accordance with Subtopic 321-10 and amortization of any discount or premium on debt securities or financing receivables. The adjusted basis is the cost basis adjusted for the allowance for credit losses account recorded in accordance with Topic 326 on measurement of credit losses for an investee financing receivable and debt security and the cumulative equity method losses applied to the other investments. Equity method income subsequently recorded shall be applied to the adjusted basis of the other investments in reverse order of the application of the equity method losses (that is, equity method income is applied to the more senior investments first).

**35-26** If the investor has other investments in the investee (including, but not limited to, preferred stock, debt securities, and loans to the investee) that are within the scope of Subtopic 310-10, 320-10, or 321-10, the investor should perform all of the following steps to determine the amount of equity method loss to report at the end of a period:

a. Apply this Subtopic to determine the maximum amount of equity method losses.
b. Determine whether the adjusted basis of the other investment(s) in the investee is positive, and do the following:
    1. If the adjusted basis is positive, the adjusted basis of the other investments shall be adjusted for the amount of the equity method loss based on the investments' seniority. Paragraph 320-10-35-3 explains that, for investments accounted for in accordance with Subtopic 320-10, this adjusted basis becomes the debt security's basis from which subsequent changes in fair value are measured. Paragraph 321-10-35-5 explains that for investments accounted for in accordance with Subtopic 321-10, this adjusted basis becomes the equity security's basis from which subsequent changes in fair value are measured.
    2. If the adjusted basis reaches zero, equity method losses shall cease being reported; however, the investor shall continue to track the amount of unreported equity method losses for purposes of applying paragraph 323-10-35-20. If one of the other investments is sold at a time when its carrying value exceeds its adjusted basis, the difference between the cost basis of that other investment and its adjusted basis at the time of sale represents equity method losses that were originally applied to that other investment but effectively reversed upon its sale. Accordingly, that excess represents unreported equity

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

method losses that shall continue to be tracked before future equity method income can be reported. Example 4 (see paragraph 323-10-55-30) illustrates the application of (b)(2).

c. After applying this Subtopic, apply Subtopics 310-10, 320-10, 321-10, 326-20, and 326-30 to the adjusted basis of the other investments in the investee, as applicable.

d. Apply appropriate generally accepted accounting principles (GAAP) to other investments that are not within the scope of Subtopic 310-10, 320-10, 321-10, 326-20, or 326-30.

Example 4 (see paragraph 323-10-55-30) illustrates the application of this guidance.

When losses from an equity method investment have reduced the equity method investment's carrying amount to zero, the investor generally stops recognizing further equity method losses unless it either has guaranteed the investee's obligations or is obligated to provide additional financial support to the investee. [323-10-35-19 – 35-20]

When an investor has provided additional financial support to an investee and its equity method investment has been reduced to zero, equity method losses continue to be recognized to the extent of (and as an adjustment to the adjusted basis of) other investments in the order of their seniority. [323-10-35-23 – 35-26]

If additional financial support is in the form of a financial instrument in the scope of Topic 326, it is subject to one of the credit loss models under that Topic. For example, credit losses are recognized under Topic 326 for the following forms of additional financial support:

- loans made to an equity method investee (Subtopic 326-20);
- investments in HTM debt securities issued by the investee (Subtopic 326-20); and
- investments in AFS debt securities issued by the investee (Subtopic 326-30).

Subtopic 323-10 explains how losses are allocated to additional investments in the investee and how these allocations affect subsequent recognition of equity method income.

## **Question 15.2.10** Is an additional investment's allowance for credit losses estimated before or after allocating equity method losses?

**Interpretive response:** The allowance for credit losses is estimated after equity method losses are allocated to the investments in the scope of Topic 326. [323-10-35-25 – 35-26]

Subtopic 323-10 indicates the sequence in which US GAAP should be applied when an entity has an equity method investment and an additional investment in an investee. The sequence can be summarized as follows. [323-10-35-25 – 35-26]

- Apply Subtopic 323-10 to determine the maximum amount of equity method losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- Determine whether the adjusted basis[1] of the additional investment is positive.
  - If the adjusted basis of the additional investment is positive, it is allocated equity method losses based on the investments' seniority.
  - If the adjusted basis has been reduced to zero, equity method losses generally are no longer allocated. However, the amount of unreported equity method losses is tracked for other purposes, such as for recognizing future equity method income.
- Apply Subtopics 310-10 (loans, receivables, etc.), 320-10 (debt securities), 321-10 (equity securities), 326-20 and 326-30 to the adjusted basis of the other investments in the investee, as applicable.
- Apply relevant US GAAP to other investments that are outside the scope of Subtopics 310-10, 320-10, 321-10, 326-20 or 326-30.

The allowance for credit losses reflects an entity's expected credit losses of the amortized cost basis. Because allocating equity method losses to an investment in the scope of Topic 326 adjusts the investment's amortized cost, recognition of equity method losses may affect the recognition of credit losses. [326-20-30-4 – 30-5]

Example 15.2.10 illustrates how to account for both credit losses and equity method losses attributable to other investments that are financial instruments subject to Subtopic 326-20. Also see Example 4 (investee losses when investor has other investments in the investee) and Example 5 (percentage used to determine equity method losses) in Section 323-10-55. [323-10-55-30 – 55-57]

Note:

1. For this step, the adjusted basis is the original cost as previously adjusted in previous periods for the following:
   - the effects of writedowns, unrealized holding gains and losses on debt securities classified as trading or equity securities accounted for under Subtopic 321-10 (equity securities);
   - amortization of any discount or premium on debt securities or financing receivables;
   - the allowance for credit losses (if applicable); and
   - the cumulative equity method losses applied to the other investments.

## **Example 15.2.10** Interaction of Subtopic 326-20 and Subtopic 323-10

Investor owns 40% of the outstanding common stock of Investee. Because Investor has significant influence over Investee, it accounts for its common stock investment using the equity method.

Investor's carrying amount in its common stock investment in Investee has been reduced to zero by the beginning of Year 1 because of its recognition of its share of previous losses incurred by Investee.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

At the beginning of Year 1, Investor extends $100 in loans to Investee, which represents 20% of all loans extended to Investee. Investor is not obligated to provide additional funding to Investee.

Investor's accounting policy is to recognize equity method losses based on the ownership level of Investee's security, loan or advance held by Investor to which equity method losses are being applied.

Investee's operating income (loss) for Years 1 through 3 is as follows.

| Year | Investee operating income (loss) |
|---|---|
| 1 | (300) |
| 2 | (150) |
| 3 | 450 |

Expected credit losses related to Investor's loans to Investee (estimated based on the $100 principal balance) at the end of Years 1 through 3 are as follows.

| Year | Calculated based on $100 principal balance | |
|---|---|---|
| | Amount expected to be collected | Expected credit losses[1] |
| 1 | 30 | 70 |
| 2 | 20 | 80 |
| 3 | 60 | 40 |

Note:

1. These amounts do not necessarily represent the allowance for credit losses because the allowance reflects an entity's expected credit losses of the amortized cost basis, which takes into consideration allocation of equity method losses.

A roll-forward of Investor's loans to Investee during Years 1 through 3 is as follows.

| Year | Beginning adjusted loan basis[1] | Investor's share of operating income (loss) applicable to the loan[2] | Credit loss expense[3] | Ending adjusted loan basis[4] |
|---|---|---|---|---|
| 1 | 100 | (60) | 10 | 30 |
| 2 | 30 | (30) | 0 | 0 |
| 3 | 0 | 90 | 30 | 60 |

Notes:

1. The adjusted basis is its original cost ($100) adjusted for the allowance for credit losses account and cumulative equity method losses allocated to the loan. [323-10-35-25]
2. Investor's share of operating income (loss) is calculated as follows. [323-10-35-26(b)]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- In periods of loss, 20% (Investor's share of Investee loans outstanding) of Investee's losses once Investor's common stock investment has been reduced to $0. The loss is limited to the beginning adjusted loan basis, with unreported equity method losses tracked.
- In periods of income, 20% of income, but limited to the amount required to restore the balance (i.e. to reverse cumulative equity method losses), after consideration of unreported equity method losses.

3. The amount needed to adjust the allowance for credit losses to expected credit losses under Subtopic 326-20 (from table above) after considering cumulative equity method losses allocated to the loan.
4. Beginning adjusted loan basis + Investor's share of operating income (loss) applicable to the loan – credit loss expense.

***Journal entries for Year 1***

At the end of the Year 1, Investor records the following journal entries.

| | Debit | Credit |
|---|---|---|
| Equity method loss[1] | 60 | |
| Loan to Investee | | 60 |
| *To record equity method loss for Investee.* | | |
| Credit loss expense[2] | 10 | |
| Allowance for credit losses | | 10 |
| *To record expected credit losses on loan to Investee.* | | |

Notes:
1. $300 (Investee's operating loss in Year 1) × 20% (Investor's share of loans extended to Investee).
2. Expected credit losses at the end of Year 1 of $70 less $60 equity method losses allocated to the loan.

At the end of Year 1, Investor's financial statements reflect the following amounts.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Investment in Investee common stock | 0 |
| Loan to Investee | 40 |
| Allowance for credit losses | (10) |
| **Income statement** | |
| Credit loss expense | (10) |
| Income (loss) from equity method investment in Investee | (60) |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### *Journal entries for Year 2*

At the end of Year 2, Investor records the following journal entry.

| | Debit | Credit |
|---|---|---|
| Equity method loss[1] | 30 | |
| Loan to Investee | | 30 |
| *To record equity method loss for Investee.* | | |

Note:

1. $150 (Investee's operating loss in Year 2) × 20% (Investor's share of loans extended to Investee) = maximum equity method loss of $30. This is compared to the adjusted basis of Investor's loan of $30. The equity method loss allocated is limited to the $30 adjusted basis. [323-10-35-24 – 35-26]

Because the adjusted basis of the loan was reduced to zero as a result of applying equity method losses to the loan (see Note 1 of the journal entries for Year 2), no entry is needed to reflect the additional expected credit losses of $10 in Year 2 determined under Subtopic 326-20.

At the end of Year 2, Investor's financial statements reflect the following amounts.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Investment in Investee common stock | 0 |
| Loan to Investee | 10 |
| Allowance for credit losses | (10) |
| **Income statement** | |
| Credit loss expense | 0 |
| Income (loss) from equity method investment in Investee | (30) |

### *Journal entries for Year 3*

At the end of Year 3, Investor records the following journal entries.

| | Debit | Credit |
|---|---|---|
| Loan to Investee | 90 | |
| Equity method income[1] | | 90 |
| *To record equity method income for Investee.* | | |
| Credit loss expense[2] | 30 | |
| Allowance for credit losses | | 30 |
| *To record expected credit losses on loan to Investee.* | | |

Notes:

1. $450 (Investee's operating income in Year 3) × 20% (Investor's share of loans extended to Investee) = maximum equity method income of $90. The limit to the amount of Investee's income that Investor is permitted to recognize is $90,

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

which is the amount required to reverse cumulative equity method losses recognized [Year 1 ($60) + Year 2 ($30) = ($90)]. This is allocated to Investor's investments in Investee in reverse order of the application of equity method losses. [323-10-35-22, 35-25]

2. Expected credit losses as of the end of Year 3 of $40 less cumulative equity method losses allocated to the loan ($60 + $30 – $90) and previously recognized credit losses of ($10) = $30.

At the end of Year 3, Investor's financial statements reflect the following amounts.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Investment in Investee common stock | 0 |
| Loan to Investee | 100 |
| Allowance for credit losses | (40) |
| **Income statement** | |
| Credit loss expense | (30) |
| Income (loss) from equity method investment in Investee | 90 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 16. Net investment in leases

## Detailed contents

**16.1 How the standard works**

**16.2 Measuring impairment**

16.2.10 Overview

**Questions**

**Question 16.2.10** Why is the unguaranteed residual asset included with the lease receivable when measuring impairment of the net investment in the lease?

**Question 16.2.20** Does the lessor consider the cash flows it expects from the leased asset after the end of the lease term when measuring its loss allowance?

**Question 16.2.30** Does a lessor consider expected gains from the subsequent disposal of leased assets when measuring its loss allowance?

**Question 16.2.35** What is the 'contractual term' for a net investment in a lease when estimating the loss allowance?

**Question 16.2.40** Does a lessor consider a third-party residual value guarantee when measuring a loss allowance?

**Question 16.2.50** When does the collateral-dependent practical expedient apply for measuring a loss allowance for a net investment in a lease?

**Examples**

**Example 16.2.10** Estimating the loss allowance for a pool of leases

**Example 16.2.20** Estimating the loss allowance when a gain is expected upon disposition of leased assets

**16.3 Sale of the lease receivable**

16.3.10 Overview

**16.4 Lease termination**

16.4.10 Overview

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 16.1 How the standard works

When a lessor classifies a lease as a sales-type or direct financing lease under Topic 842 (leases), it recognizes a net investment in the lease.

The net investment in the lease is subject to the impairment guidance in Subtopic 326-20. A lessor estimates a loss allowance on its entire net investment in the lease, including the unguaranteed residual value.

Unlike net investments in leases that are classified as sales-type or direct financing leases, receivables arising from operating leases are outside the scope of Subtopic 326-20.

For an in-depth analysis of the accounting for leases under Topic 842, see KPMG Handbook, Leases.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 16.2 Measuring impairment

## 16.2.10 Overview

### Excerpt from ASC 326-20

• > Net investment in Leases

**55-8** This Subtopic requires that an entity recognize an allowance for credit losses on net investment in **leases** recognized by a **lessor** in accordance with Topic 842 on leases. An entity should include the unguaranteed residual asset with the lease receivable, net of any deferred selling profit, if applicable (that is, the net investment in the lease). When measuring expected credit losses on net investment in leases, the **lease term** should be used as the contractual term. When measuring expected credit losses on net investment in leases using a discounted cash flow method, the discount rate used in measuring the lease receivable under Topic 842 should be used in place of the **effective interest rate**.

### Excerpt from ASC 842-30

**20 Glossary**

**Lease Receivable**

A **lessor's** right to receive **lease payments** arising from a **sales-type lease** or a **direct financing lease** plus any amount that a lessor expects to derive from the underlying asset following the end of the **lease term** to the extent that it is guaranteed by the lessee or any other third party unrelated to the lessor, measured on a discounted basis.

**Net Investment in the Lease**

For a **sales-type lease**, the sum of **the lease receivable** and the **unguaranteed residual asset**.

For a **direct financing lease**, the sum of the lease receivable and the unguaranteed residual asset, net of any deferred selling profit.

**Unguaranteed Residual Asset**

The amount that a **lessor** expects to derive from the **underlying asset** following the end of the **lease term** that is not guaranteed by the **lessee** or any other third party unrelated to the lessor, measured on a discounted basis.

• > Loss Allowance on the Net Investment in the Lease

**35-3** A **lessor** shall determine the loss allowance related to the **net investment in the lease** and shall record any loss allowance in accordance with Subtopic 326-20 on financial instruments measured at amortized cost. When determining the loss allowance for a net investment in the lease, a lessor shall take into consideration the collateral relating to the net investment in the lease. The collateral relating to the net investment in the lease

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

represents the cash flows that the lessor would expect to receive (or derive) from the **lease receivable** and the **unguaranteed residual asset** during and following the end of the remaining **lease term**.

For sales-type and direct financing leases, a lessor generally recognizes a net investment in the lease on its balance sheet and derecognizes the leased asset.

The net investment in the lease includes the following. [842-30-25-1, 25-3 – 25-8, 30-1 – 30-2, 40-1]

- For sales-type leases, the lease receivable and an unguaranteed residual asset.
- For direct financing leases, the lease receivable and an unguaranteed residual asset, reduced by any deferred selling profit on the lease.

A lessor assesses its entire net investment in the lease for impairment – i.e. including the unguaranteed residual value – and recognizes any impairment loss under Subtopic 326-20. A lessor does not separately evaluate the unguaranteed residual asset for impairment unless it sells the lease receivable and retains the unguaranteed residual asset. For a discussion of the accounting for a retained unguaranteed residual asset after the sale of a lease receivable, see section 16.3. [ASU 2016-02.BC311]

When estimating the loss allowance for a net investment in the lease, the lessor considers the collateral relating to the net investment in the lease. The collateral represents the cash flows that the lessor would expect to receive (or derive) from the lease receivable and the unguaranteed residual asset during and following the end of the remaining lease term – e.g. from sale or re-lease of the asset for the remainder of the lease term, including an expected lump-sum payment related to the residual value of the asset at the end of the lease term (see Question 16.2.20). [842-30-35-3]

If an entity uses a discounted cash flow method to estimate impairment, it uses the same discount rate that it uses to measure the lease receivable. [326-20-55-8]

## **Question 16.2.10** Why is the unguaranteed residual asset included with the lease receivable when measuring impairment of the net investment in the lease?

**Interpretive response:** In its deliberations of the new leases standard, the FASB decided that even though the unguaranteed residual asset does not meet the definition of a financial asset, it would be overly complex and provide little benefit to assess the components of the net investment – i.e. lease receivable and unguaranteed residual asset – under different impairment models. [ASU 2016-02.BC310]

The FASB concluded that it would be appropriate to assess the entire net investment under the financial instruments impairment model because most of the net investment comprises the lease receivable. The FASB also considered that lessors generally look to realize any expected residual value from the asset through a sale of the asset to the lessee or another party. Therefore, treating

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

the entire net investment as a future cash flow stream when evaluating impairment is consistent with how lessors generally view their net investment in a lease. [ASU 2016-02.BC311]

## **Question 16.2.20** Does the lessor consider the cash flows it expects from the leased asset after the end of the lease term when measuring its loss allowance?

**Interpretive response:** Yes. A lessor considers the collateral relating to the net investment in the lease when estimating the loss allowance, if any, for its net investment in the lease.

Paragraph 842-30-35-3 (as amended by ASU 2018-10) states that collateral "represents the cash flows that the lessor would expect to receive (or derive) from the lease receivable and the unguaranteed residual asset during and following the end of the remaining lease term." This reflects the FASB's intent that the cash flows that could be obtained from sale or re-lease of the leased asset following the end of the lease term are to be considered as part of the collateral relating to the net investment in the lease when assessing the net investment for impairment.

Because a lessor assesses the entire net investment in the lease (which includes any unguaranteed residual value of the leased asset) for impairment, not considering expected cash flows to be derived following the lease term would result in impairment recognition even when no loss is expected. This situation would occur because the impairment assessment would potentially ignore cash flows from sale or re-lease of the leased asset.

Therefore, a lessor's determination of its loss allowance for a net investment in a lease includes an assumed lump-sum payment amount based on the expected cash flows associated with the residual asset following the lease term. If the asset is expected to be re-leased, the assumed lump-sum payment amount consists of the net present value of:

- gross expected cash flows from expected re-lease; and
- expected payment for the residual value of the asset at the end of the re-lease term.

The estimate of these assumed cash inflows considers the possible amounts that the lessor might realize from the residual asset based on its expected market value at the end of the lease (e.g. from sale of the asset at auction). As a result, impairment of the net investment in the lease under Subtopic 326-20 is estimated considering both credit risk and non-credit risk relating to the unguaranteed residual asset.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 16.2.10** Estimating the loss allowance for a pool of leases

The following example is not intended to prescribe any specific method for estimating expected losses for a lease portfolio. Rather, it is intended to demonstrate one potential method that an entity could apply.

Lessor (LR) is in the business of leasing bulldozer model XYZ for use in construction. LR has aggregated its leases into five pools (see chapter 5) for collective measurement of impairment based on similar risk characteristics.

LR analyzes its historical loss experience for each pool to develop loss rates. This example focuses on one of those pools (Pool A). All of the leases in Pool A have the same remaining duration (five years), original contractual term, lessee credit risk rating and leased asset type (bulldozer model XYZ).

LR considers the current and forecasted direction of the economic environment, and develops historical loss rates using historical periods that are closest to its expectations.

In calculating the historical loss rates, LR determines separate loss rates for each of the following risks.

- **Credit risk.** This loss rate represents both the probability that lessees will default on making their lease payments and the magnitude of the losses experienced when these defaults occur.
  - The magnitude of the losses experienced when these defaults occur is affected by both the amount of the net investment in the lease and the fair value of the leased asset at the date of default. In many circumstances, the magnitude may be higher when the default occurs earlier in the lease term. This is because lease payments are typically made on a straight-line basis while the asset's decline in fair value may be more significant in the earlier periods. This creates the potential for greater credit loss exposure in the earlier periods.
  - For this risk, LR has chosen to determine the loss rate as a percentage of the original pool balance. The original pool balance comprises the sum of the net investment in the lease balances for all leases in Pool A – i.e. the lease receivable and unguaranteed residual asset balances – as of the origination date.
- **Non-credit risk.** This loss rate represents the likelihood that a loss will occur on a leased asset despite the lessee making all contractual lease payments.
  - As explained in Question 16.2.10, this risk is considered because the net investment in the lease includes a nonfinancial (unguaranteed residual asset) component.
  - For this risk, LR has chosen to determine the loss rate as a percentage of the unguaranteed residual asset balance (undiscounted).

LR chooses to determine these loss rates separately because it believes that they will differ significantly. This is because (1) the loss rate related to credit risk is significantly affected by changes in the likelihood of lessees making their

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

lease payments, and (2) the magnitude of the losses (when they occur) has differed between those occurring during the lease term and those occurring at the end of the lease term.

For Pool A, the relevant historical experience based on the remaining duration of the leases demonstrated the following.

- **Credit risk.** The lessees defaulted on 5% of leases (i.e. probability of default), and losses experienced on those leases averaged 22% of the original net investment in the lease balance (i.e. loss given default). The average amount includes both leases that experienced a loss upon default and leases that defaulted but did not result in a loss because the fair value of the leased asset exceeded the net investment in the lease. This results in a credit risk loss rate of 1.10% of the historical pools' original balance (5% × 22%).
- **Non-credit risk.** For the remaining 95% of leases on which the lessees did not default, LR experienced losses averaging 11% of the original unguaranteed residual asset balance on those leases. This results in a non-credit risk loss rate of 10.45% of the historical pools' unguaranteed residual asset balances (95% × 11%).

In determining whether the historical loss rates should be adjusted, LR concludes the following.

- No adjustments are necessary for differences in current asset-specific risk characteristics – e.g. underwriting standards, portfolio mix or asset term within the pool.
- The following primary factors could affect expected collectibility.
  - **GDP growth rate.** The GDP growth rate is expected to affect the likelihood of a lessee defaulting. LR concludes that GDP growth is expected to be worse than experienced in the historical period, and as a result there will be an increase in the probability that a lessee will default.

    LR determines that an increase of 1% should be made to the pool's probability of default to reflect current conditions and reasonable and supportable forecasts.

    To prevent double-counting, a corresponding decrease is made to the non-credit risk historical rate. This is because a lease is assumed to terminate at the date of default. As a result, there cannot be both a loss on default and a loss at the end of the lease term.
  - **Bulldozer model XYZ fair values.** The fair values of bulldozer model XYZ will affect the magnitude of losses experienced. LR concludes that bulldozer model XYZ fair values are expected to depreciate more quickly than expected at lease inception, and also more quickly than what was experienced in the historical period. This will result in an increase in the estimated magnitude of losses – i.e. the loss given default for credit risk and loss if no default occurs for non-credit risk – occurring for both credit and non-credit risk.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

LR determines that an adjustment should be made to increase the magnitude of expected losses by 2% for credit risk and 0.5% for non-credit risk.

- LR is able to obtain a reasonable and supportable forecast of economic conditions for the remaining duration of the Pool A assets. As a result, no reversion adjustment is necessary.

LR calculates its estimate of the loss allowance as follows.

| Risk | Historical rates (before adjust.) | Adjustments[1] | | Expected rates[4] | Original balance[5] | Expected credit losses |
|---|---|---|---|---|---|---|
| | | GDP growth rate | Bulldozer model XYZ values | | | |
| **Credit risk** | | | | | | |
| Probability of default | 5% | 1% | | 6% | | |
| Loss given default[6] | 22% | | 2% | 24% | | |
| Total loss rate[2,6] | 1.10% | | | 1.44% | 12,000,000 | 172,800 |
| **Non-credit risk** | | | | | | |
| Probability no default will occur | 95% | -1% | | 94% | | |
| Loss if no default occurs[7] | 11% | | 0.5% | 11.5% | | |
| Total loss rate[3,7] | 10.45% | | | 10.81% | 840,000 | 90,804 |
| Pool A – Total expected losses | | | | | | 263,604 |

Notes:

1. Adjustments for current conditions, and reasonable and supportable forecasts.
2. Probability of default × loss given default.
3. Probability no default will occur × loss if no default occurs.
4. Unadjusted historical loss rates + adjustments for current conditions and reasonable and supportable forecasts.
5. The original balance comprises:
   - for credit risk, the original net investment in the lease balance, including lease receivables and unguaranteed residual asset amounts; and
   - for non-credit risk, the original balance of unguaranteed residual assets (undiscounted).
6. These rates are expressed as a percentage of the original net investment in the lease balance.
7. These rates are expressed as a percentage of the original balance of unguaranteed residual assets.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 16.2.30** Does a lessor consider expected gains from the subsequent disposal of leased assets when measuring its loss allowance?

**Background:** A lessor's estimate of the loss allowance for a net investment in the lease considers the cash flows that the lessor expects to receive (or derive) from the lease receivable and the unguaranteed residual asset during and following the end of the remaining lease term. When a leased asset is returned to the lessor on early termination of the lease or at the end of the lease term, the lessor may either sell or re-lease the asset. Sometimes, a lessor realizes a gain when it disposes of a leased asset – e.g. it sells the asset at the end of the lease term for an amount greater than the balance of the unguaranteed residual asset.

**Interpretive response:** Yes. If a lessor's consideration of past events, current conditions and reasonable and supportable forecasts result in the lessor expecting to realize gains from the subsequent disposal of leased assets, those gains from disposal are to be reflected in the lessor's loss allowance except as noted below. [TRG 06-18.7, TRG 06-18.13]

When determining the loss allowance, paragraph 842-30-35-3 requires the lessor to consider the cash flows it expects from the collateral, but does not indicate whether it applies to both gains and losses on disposal. The FASB staff believes expected gains and losses should be considered regardless of whether the loss allowance is measured for an individual lease or a pool of leases. [842-30-35-3, TRG 06-18.7, TRG 06-18.13]

When measuring it's loss allowance, we believe a lessor includes expected gains and losses on disposal and expected credit losses on its lease receivable. However, expected gains may not be included in the loss allowance to the extent such gains would result in the allowance being negative (a debit balance). An entity evaluates whether expected gains would result in a negative allowance at the level at which it aggregates its leases for measurement of the loss allowance based on similar risk characteristics. See chapter 5 for guidance on collective assessments.

## **Example 16.2.20** Estimating the loss allowance when a gain is expected upon disposition of leased assets

This example is a modification of Example 16.2.10.

In that example, Lessor (LR) develops separate loss rates for each credit and non-credit risk for one pool (Pool A) of its leases. LR develops loss rates based on (1) its historical experience as adjusted for current conditions, and (2) reasonable and supportable forecasts related to the GDP growth rate and to bulldozer model XYZ fair values. LR is able to obtain a reasonable and supportable forecast of economic conditions for the remaining duration of Pool A assets.

Unlike that example, it is now assumed that LR's historical experience for non-credit risk is that LR experienced gains averaging 5% (rather than losses averaging 11%) of the original unguaranteed residual balance on those leases.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

This results in a non-credit risk rate of -4.75% (i.e. a gain related to non-credit risk) of the historical pools' unguaranteed residual asset balances (95% × -5%).

LR calculates its estimate of the loss allowance as follows.

| Risk | Historical rates (before adjust.) | Adjustments[1] | | Expected rates[4] | Original balance[5] | Expected credit losses |
|---|---|---|---|---|---|---|
| | | GDP growth rate | Bulldozer model XYZ values | | | |
| **Credit risk** | | | | | | |
| Probability of default | 5% | 1% | | 6% | | |
| Loss given default[6] | 22% | | 2% | 24% | | |
| Total loss rate[2,6] | 1.10% | | | 1.44% | 12,000,000 | 172,800 |
| **Non-credit risk** | | | | | | |
| Probability no default will occur | 95% | -1% | | 94% | | |
| Loss (gain) if no default occurs[7] | -5% | | 0.5% | -4.5% | | |
| Total loss (gain) rate[3,7] | -4.75% | | | -4.23% | 840,000 | (35,532) |
| Pool A – Total expected losses | | | | | | 137,268 |

Notes:

1. Adjustments for current conditions, and reasonable and supportable forecasts.
2. Probability of default × loss given default.
3. Probability that no default will occur × loss (gain) if no default occurs.
4. Unadjusted historical rates + adjustments for current conditions and reasonable and supportable forecasts.
5. The original balance comprises:
   - for credit risk, the original net investment in the lease balance, including lease receivables and unguaranteed residual asset amounts; and
   - for non-credit risk, the original balance of unguaranteed residual assets (undiscounted).
6. These rates are expressed as a percentage of the original net investment in the lease balance.
7. These rates are expressed as a percentage of the original balance of unguaranteed residual assets.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 16.2.35** What is the 'contractual term' for a net investment in a lease when estimating the loss allowance?

### Excerpt from ASC 326-20

> Developing an Estimate of Expected Credit Losses

**30-6A** For net investment in **leases** recognized by a lessor in accordance with Topic 842, instead of applying the guidance in paragraph 326-20-30-6, an entity shall use the **lease term** as the contractual term.

**Interpretive response:** The contractual term used when estimating the loss allowance for a net investment in a lease should be the 'lease term' of the lease. The lease term includes the non-cancellable period of the lease together with periods covered by all of the following: [326-20-30-6A]

- an option held by the lessor to extend (or not terminate) the lease;
- an option held by the lessee to extend the lease if it is reasonably certain the lessee will exercise the option to extend; and
- an option held by the lessee to terminate the lease if it is reasonably certain the lessee will not exercise the option to terminate.

This definition is consistent with the definition of lease term in Topic 842. As a result, we believe an entity applies all of the related guidance in Topic 842 when applying this definition (see section 5.3 of KPMG Handbook, Leases). [842-10-30-1]

## **Question 16.2.40** Does a lessor consider a third-party residual value guarantee when measuring a loss allowance?

**Interpretive response:** Yes. A lessor includes expected cash flows from a third-party residual value guarantee when measuring its loss allowance. A lessor's estimate of the loss allowance for a net investment in a lease considers the cash flows that the lessor expects to receive (or derive) from the lease receivable and the unguaranteed residual asset. [326-20-55-8]

The cash flows from the lease receivable include the sum of the present value of: [842-30 Glossary]

- future lease payments from the lessee; and
- any residual value guarantee provided by the lessee or a third party.

The FASB decided the net investment should be treated as a single unit of account for purposes of measuring the loss allowance. Further, the net investment specifically includes the guaranteed residual value of the leased asset. Therefore, even if the third-party guarantee was considered a freestanding contract, we believe the guidance that precludes an entity from considering freestanding contracts for the purposes of estimating expected credit losses does not apply to third-party guarantees of the residual value of

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

the leased asset in sales-type and direct financing leases. [ASU 2018-10.BC33, 326-20-30-12]

## **Question 16.2.50** When does the collateral-dependent practical expedient apply for measuring a loss allowance for a net investment in a lease?

**Background:** When an entity determines that foreclosure is probable, it is required to use the collateral's fair value to estimate the financial asset's expected credit losses for the current reporting period. [326-20-35-4]

When foreclosure is not probable, an entity can elect the practical expedient if: [326-20-35-5]

- repayment is expected to be provided substantially through the operation or sale of the collateral; and
- the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date.

**Interpretive response:** We believe the applicability of the practical expedient depends on the financial condition of the lessee and how the lessor expects to realize its net investment in the lease.

- If the lessee is expected to perform and make all rental payments, and the leased asset is expected to be returned to the lessor at the end of the lease term in accordance with the lease contract, we do not believe the collateral-dependent practical expedient may be applied.
- If it is probable that the lessee will default on its lease rentals, and therefore the lessor will take (or retake) possession of the leased asset before the end of the lease term, we believe a lessor must apply the collateral-dependent practical expedient.
- If the lessee is experiencing financial difficulty *and* the net investment in the lease is expected to be realized substantially through the sale of the leased asset or through repossession and re-lease to a third-party lessee, we believe the collateral-dependent practical expedient may be applied. Importantly, just because the lessee is experiencing financial difficulty does not mean the lessee is expected to default on the lease; and if it is not expected to default, the lessor does not expect to realize the net investment in the lease principally through the sale or re-lease of the leased asset – i.e. it still expects to realize the net investment substantially through the lease payments.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 16.3 Sale of the lease receivable

## 16.3.10 Overview

### Excerpt from ASC 842-30

• > Sale of the Lease Receivable

**35-4** If a **lessor** sells substantially all of the **lease receivable** associated with a **sales-type lease** or a **direct financing lease** and retains an interest in the **unguaranteed residual asset**, the lessor shall not continue to accrete the unguaranteed residual asset to its estimated value over the remaining **lease term**. The lessor shall report any remaining unguaranteed residual asset thereafter at its carrying amount at the date of the sale of the lease receivable and apply Topic 360 on property, plant, and equipment to determine whether the unguaranteed residual asset is impaired.

The entire net investment in a lease (including the unguaranteed residual asset) is generally in the scope of Subtopic 326-20. However, if a lessor sells the lease receivable and retains an interest in the unguaranteed residual asset, Subtopic 326-20 no longer applies to the unguaranteed residual asset.

On the sale of all, or substantially all, of the lease receivable, the lessor reports any remaining unguaranteed residual asset at its carrying amount at the sale date. It also applies Topic 360 (property, plant and equipment) – rather than Subtopic 326-20 – to determine whether the unguaranteed residual asset is impaired. [842-30-35-4]

# 16.4 Lease termination

## 16.4.10 Overview

### Excerpt from ASC 842-30

• > Lease Termination

**40-2** If a **sales-type lease** or a **direct financing lease** is terminated before the end of the **lease term**, a **lessor** shall do all of the following:

a. Measure the **net investment in the lease** for credit losses in accordance with Subtopic 326-20 on financial instruments measured at amortized cost and record any credit loss identified
b. Reclassify the net investment in the lease to the appropriate category of asset in accordance with other Topics, measured at the sum of the carrying amounts of the **lease receivable** (less any amounts still expected to be received by the lessor) and the residual asset
c. Account for the **underlying asset** that was the subject of the **lease** in accordance with other Topics.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

If a sales-type or direct financing lease is terminated before the end of the lease term, the lessor first applies the guidance in Subtopic 326-20 to determine if any additional impairment (including related credit losses) should be recognized. [842-30-40-2(a)]

After recognizing its estimate of expected losses, the lessor reclassifies the net investment in the lease (which is comprised of the carrying amounts of the lease receivable – less amounts the lessor still expects to receive – and the residual asset) to the appropriate category of asset and accounts for it under other US GAAP. [842-30-40-2(b) – 40-2(c)]

By first applying Subtopic 326-20, the lessor ensures that the carrying amount is accurate before it is reclassified to other categories.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 17. Specific considerations for insurance entities

## Detailed contents

**17.1 How the standard works**

**17.2 Scope**

17.2.10 Overview

**17.3 Measurement**

17.3.10 Exposure to risks other than credit risk

17.3.20 Collective measurement

17.3.30 Credit enhancements

17.3.40 Collateral maintenance provisions

17.3.50 Other insurer-specific items

**Questions**

**Question 17.3.05** What risk characteristics are evaluated when determining if reinsurance recoverables have similar risk characteristics?

**Question 17.3.10** Does the monthly or quarterly evaluation of a trust account for required collateral replenishment meet the requirement to continually adjust the amount of collateral?

**Question 17.3.20** [Not used]

**Question 17.3.30** What effect does the unearned premium reserve have on the estimate of expected credit losses for premiums receivable?

**Question 17.3.40** What is considered when assessing the collectibility of reinsurance recoverables?

**Question 17.3.50** How are government established indemnification programs considered when estimating expected credit losses?

**Examples**

**Example 17.3.10** [Not used]

**Example 17.3.20** Evaluation of whether a letter of credit for a reinsurance contract is a freestanding or embedded credit enhancement

**Example 17.3.30** Evaluation of whether a trust account for a reinsurance contract is a freestanding or embedded credit enhancement

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 17.1 How the standard works

This chapter focuses on aspects of the expected credit loss model for financial assets in the scope of Subtopic 326-20 that are specific to insurance entities.

This chapter first addresses whether certain financial assets typically held by insurance entities are in the scope of Subtopic 326-20. It then addresses the following issues in the context of insurance related receivables and reinsurance recoverables:

- which risks are included in the estimate of expected credit losses;
- how to consider similar risk characteristics to collectively estimate expected credit losses;
- how to determine whether a credit enhancement is considered when estimating expected credit losses;
- whether a collateral maintenance provision can support an expected credit loss of zero; and
- how to consider certain insurance specific items, including the unearned premium reserve and government indemnification programs.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 17.2 Scope

## 17.2.10 Overview

### Excerpt from ASC 326-20

> Instruments

**15-2** The guidance in this Subtopic applies to the following items:

a. Financial assets measured at amortized cost basis, including the following:
   1. **Financing receivables**
   2. Held-to-maturity **debt securities**
   3. Receivables that result from revenue transactions within the scope of Topic 605 on revenue recognition, Topic 606 on revenue from contracts with customers, and Topic 610 on other income
   4. Subparagraph superseded by Accounting Standards Update No. 2019-04.
   5. Receivables that relate to repurchase agreements and securities lending agreements within the scope of Topic 860

…

d. **Reinsurance recoverables** that result from insurance transactions within the scope of Topic 944 on insurance.

**20 Glossary**

**Reinsurance Recoverable**

All amounts recoverable from reinsurers for paid and unpaid claims and claim settlement expenses, including estimated amounts receivable for unsettled claims, claims incurred but not reported, or policy benefits.

As more fully explained in chapter 2, financial assets measured at amortized cost are subject to the expected credit loss guidance in Subtopic 326-20.

Insurance entities commonly hold the following types of financial assets in the scope of Subtopic 326-20:

- financing receivables; [326-20-15-2(a)(1)]]
- HTM debt securities; and [326-20-15-2(a)(2)]
- reinsurance recoverables that result from insurance transactions in the scope of Topic 944 (insurance). [326-20-15-2(d), 944-40-25-34]

An asset is a financing receivable if the balance represents a contractual right to receive money on demand or on fixed or determinable dates – e.g. a mortgage loan and note receivable are financing receivables. [326-20 Glossary, 310-10-55-14]

The following table illustrates certain insurance-specific financial assets commonly held by an insurance entity and whether they are in the scope of Subtopic 326-20.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Financial asset | Within the scope of Subtopic 326-20? |
|---|---|
| **Premiums receivable** | Yes. Premiums receivable are trade accounts receivable. Trade accounts receivable are specifically listed as a type of financing receivable in Subtopic 310-10.<br>Because premiums receivable generally meet the definition of a financing receivable, they are financial assets measured at amortized cost and are in the scope of Subtopic 326-20. [310-10-55-14(b)] |
| **Policy loan receivables** | No. Policy loan receivables are explicitly excluded from the scope of Subtopic 326-20. [326-20-15-3(d)] |
| **Funds withheld assets** | Yes. Funds withheld assets may arise in certain reinsurance contracts. Funds withheld assets are financial assets measured at amortized cost and therefore are in the scope of Subtopic 326-20. [310-10-55-14(b)] |
| **Retrospective premiums receivable** | Yes. Retrospective premiums receivable arise when an entity receives an initial premium from the contract holder and, at the end of the policy year (or longer period), the initial premium is adjusted to reflect the actual loss experience of the contract.<br>Depending on the terms of the insurance contract, the estimate of this receivable may include the estimate of incurred-but-not-reported losses in addition to actual paid losses. Retrospective premiums receivable are financial assets measured at amortized cost and therefore are in the scope of Subtopic 326-20. [310-10-55-14(b)] |
| **Reinsurance recoverables with entities under common control** | No. Because loans and receivables between entities under common control are explicitly excluded from the scope of Subtopic 326-20, reinsurance recoverables between entities under common control are not in the scope of Subtopic 326-20. The consideration of common control should follow the guidance in Topic 810 and EITF Issue No. 02-5 (see Question 2.3.20). [326-20-15-3(f)] |

Subtopic 326-20 requires an entity to estimate and recognize lifetime expected credit losses for financial assets in its scope. Certain of these financial assets are specific to insurance entities and require particular consideration.

## 17.3 Measurement

### 17.3.10 Exposure to risks other than credit risk

Subtopic 326-20 requires an entity to bifurcate credit risk from other risks that affect the collectibility of a reinsurance recoverable. [450-20-25, 326-20-55-81 – 55-82]

- An allowance for credit losses (i.e. losses due to credit risk of the reinsurer) is recognized and estimated under the expected credit loss model.
- A separate valuation allowance for the remaining risk (e.g. dispute risk, litigation risk) is recognized under Topic 450 (contingencies) if the loss associated with those risks is probable and can be reasonably estimated.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 17.3.20 Collective measurement

### Excerpt from ASC 326-20

• > Example 17: Identifying Similar Risk Characteristics in Reinsurance Recoverables

**55-81** Reinsurance recoverables may comprise a variety of risks that affect collectibility including:

a. Credit risk of the reinsurer/assuming company
b. Contractual coverage disputes between the reinsurer/assuming company and the insurer/ceding company including contract administration issues
c. Other noncontractual, noncoverage issues including reinsurance billing and allocation issues.

**55-82** This Subtopic only requires measurement of expected losses related to the credit risk of the reinsurer/assuming company**.**

**55-83** In situations in which similar risk characteristics are not present in the reinsurance recoverables, the ceding insurer should measure expected credit losses on an individual basis. Similar risk characteristics may not exist because any one or a combination of the following factors exists, including, but not limited to:

a. Customized reinsurance agreements associated with individual risk geographies
b. Different size and financial conditions of reinsurers that may be either domestic or international
c. Different attachment points among reinsurance agreements
d. Different collateral terms of the reinsurance agreements (such as collateral trusts or letters of credit)
e. The existence of state-sponsored reinsurance programs.

**55-84** However, similar risk characteristics may exist for certain reinsurance recoverables because any one or combination of the following exists:

a. Reinsurance agreements that have standardized terms
b. Reinsurance agreements that involve similar insured risks and underwriting practices
c. Reinsurance counterparties that have similar financial characteristics and face similar economic conditions.

**55-85** Judgment should be applied by ceding insurers in determining if and when similar risks exist within their reinsurance recoverables.

An entity is required to estimate expected credit losses of financial assets with similar risk characteristics on a collective (pool) basis. This includes insurance contract-related receivables and reinsurance recoverables. Example 17 in Section 326-20-55 (reproduced above) provides factors to consider when making this determination for reinsurance recoverables. For additional discussion of collective assessments, see chapter 5. [326-20-30-2]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 17.3.05** What risk characteristics are evaluated when determining if reinsurance recoverables have similar risk characteristics?

**Interpretive response:** An entity is required to estimate expected credit losses of reinsurance recoverables with similar risk characteristics on a collective (pool) basis. An entity uses its judgment to determine if and when reinsurance recoverables have similar risk characteristics. [326-20-55-83, 55-85]

Example 17 in Section 326-20-55 (reproduced above) provides factors to consider when making this determination for reinsurance recoverables. In addition to those factors, we believe an entity should also consider the:

- reinsurer's credit ratings from reputable rating agencies or its internal credit rating review process;
- geographic concentration of the business written by the reinsurer – e.g. a specific geographic region or global;
- size of the reinsurer, which might be indicative of the reinsurer's financial condition; and
- types and terms of other agreements the reinsurer has written.

Generally, we believe that significant differences in these factors indicate that the reinsurance recoverables do not have similar risk characteristics.

For additional discussion of collective assessment, see chapter 5. [326-20-30-2]

## 17.3.30 Credit enhancements

As discussed in chapter 9, an entity considers whether credit enhancements (e.g. financial guarantees) affect its estimate of expected credit losses. For a credit enhancement to be considered in an expected credit loss estimate, it cannot be a freestanding contract. Separate, freestanding contracts that serve to mitigate credit losses – such as purchased credit default swaps or certain types of insurance – are not considered for the purposes of estimating expected credit losses.

The determination of whether a credit enhancement is freestanding is based on the definition of a freestanding contract. Section 9.2.10 includes a decision tree that provides one acceptable method for performing the analysis to determine whether the credit enhancement is freestanding. Under that method, the credit enhancement is freestanding if either of the following conditions is met: [326-20 Glossary]

- the contract was entered into separate and apart from – rather than in conjunction with – some other transaction; or
- if the contract was entered into in conjunction with some other transaction, the contract is legally detachable and is separately exercisable.

An entity should evaluate the specific nature of each credit enhancement to determine whether it is freestanding. For further guidance about the evaluation of whether a credit enhancement is freestanding, see chapter 9.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### *Examples*

The following example demonstrates how to evaluate whether credit enhancements are embedded or freestanding in the specified circumstances. Credit enhancements having different forms and/or different terms may result in different conclusions regarding whether they are embedded or freestanding.

## **Example 17.3.20** Evaluation of whether a letter of credit for a reinsurance contract is a freestanding or embedded credit enhancement

Insurer is a property and casualty insurance company that writes worker's compensation insurance policies. Insurer has entered into quota share reinsurance contracts with Reinsurer where Insurer retains 75% of the risk and cedes 25% of the risk. Insurer also owns a fixed maturity security of Reinsurer.

Insurer recognizes reinsurance recoverables related to the quota share reinsurance contracts that reflect the amount of ceded risk. Insurer manages exposure to Reinsurer's credit risk in part by requiring that Reinsurer obtain and provide a letter of credit.

The following table provides an evaluation of whether two examples of credit enhancements in the form of a letter of credit are considered to be freestanding contracts. However, an insurance entity needs to evaluate its individual facts and circumstances when evaluating whether a credit enhancement is considered freestanding.

| | Scenario 1: Embedded | Scenario 2: Freestanding |
|---|---|---|
| **Description of the credit enhancement** | Reinsurer is required under the terms of the reinsurance contract to provide Insurer with a letter of credit equal to a specified percentage (102%) of ceded reserves. Reinsurer receives a letter of credit from Bank to satisfy the requirement. | Reinsurer enters into a letter of credit that is not specifically related to the reinsurance contract and can be used to cover general credit exposure to Reinsurer – i.e. both the reinsurance contract and the fixed maturity security of Reinsurer owned by Insurer. |
| **Is the credit enhancement entered into separate and apart from, or in conjunction with, the coinsurance reinsurance contract?** | The letter of credit is specific to the reinsurance contract and Reinsurer names Insurer as the beneficiary.<br>The letter of credit is issued as specifically required by the reinsurance contract.<br>The letter of credit is entered into at the timing required by the contract – e.g. contemporaneously with the execution of the reinsurance contract, contemporaneously with the effective date of the | The letter of credit is entered into separate and apart from the reinsurance contract.<br>Insurer enters into two contractually distinct instruments with separate, unrelated counterparties.<br>The quota share reinsurance contract is entered into with Reinsurer.<br>The letter of credit is entered into with Bank, a separate financial institution. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | Scenario 1: Embedded | Scenario 2: Freestanding |
|---|---|---|
| | reinsurance contract, or when the related reinsurance recoverable is recognized. | Therefore, the letter of credit is considered a freestanding contract. |
| **Is the credit enhancement legally detachable and separately exercisable?** | The letter of credit is specific to the parties to the reinsurance contract and is not separately exercisable. If Reinsurer defaults and the letter of credit is used to satisfy its obligation to Insurer, Insurer has no remaining claim against Reinsurer. If the reinsurance contract is terminated, the letter of credit is also terminated. Therefore, the credit enhancement is not legally detachable and separately exercisable. | N/A<br>When an instrument is entered into separate and apart from other transactions, it is considered freestanding and this evaluation is not required. |
| **Is the credit enhancement freestanding?** | No, the letter of credit is not freestanding. | Yes, the letter of credit is freestanding. |
| **Consideration of credit enhancement in estimating credit losses** | The credit enhancement should be considered in estimating expected credit losses because it is not a freestanding contract.<br>Bank's financial condition and ability to pay on the letter of credit should be considered in the estimate.<br>See also the discussion of collateral maintenance provisions in section 17.3.40. | The credit enhancement should *not* be considered in estimating expected credit losses because it is considered a freestanding contract. |

The following example demonstrates a trust account that is an embedded credit enhancement. However, individual facts and circumstances should be evaluated, as credit enhancements with different forms and/or terms may result in different conclusions. For further guidance about evaluating whether a credit enhancement is freestanding, see chapter 9.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Example 17.3.30** Evaluation of whether a trust account for a reinsurance contract is a freestanding or embedded credit enhancement

Life Insurer writes term life insurance policies. Life Insurer enters into a coinsurance reinsurance contract with Reinsurer whereby Life Insurer retains 60% of the risk and cedes 40% of the risk.

Life Insurer recognizes reinsurance recoverables related to the reinsurance contract that reflect the amount of ceded risk. It manages exposure to Reinsurers' credit risk in part by requiring Reinsurer to fund a trust account.

The coinsurance reinsurance contract requires Reinsurer to hold assets in a designated trust account for Life Insurer's benefit based on a specified percentage of ceded reserves (e.g. 105%). The trust agreement addresses the administration of the trust account and, if the assets held at the end of any reporting period are less than the specified percentage of ceded reserves, requires that Reinsurer transfer additional assets to the trust account to fund the shortfall within five business days.

The trust agreement is:

- specifically referred to in the coinsurance reinsurance contract;
- entered into in conjunction with the related coinsurance reinsurance contract;
- not transferable separately from the coinsurance reinsurance contract; and
- not separately exercisable.

Further, if Reinsurer defaults and the trust assets are used to satisfy its obligation to Life Insurer, then Life Insurer has no remaining claim against Reinsurer.

Therefore, the credit enhancement is not legally detachable and separately exercisable. The trust account is not a freestanding credit enhancement and should be considered in estimating expected credit losses. Reinsurer's financial condition and ability to fund trust assets should be considered in the estimate of expected credit losses.

## 17.3.40 Collateral maintenance provisions

### Excerpt from ASC 326-20

> Financial Assets Secured by Collateral Maintenance Provisions

**35-6** For certain **financial assets**, the borrower may be required to continually adjust the amount of the collateral securing the financial assets as a result of **fair value** changes in the collateral. In those situations, an entity may use, as a practical expedient, a method that compares the **amortized cost basis** with the fair value of collateral at the reporting date to measure the estimate of expected credit losses. An entity may determine that the expectation of nonpayment of the amortized cost basis is zero if the borrower continually replenishes the collateral securing the financial asset such that the fair value of

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

the collateral is equal to or exceeds the amortized cost basis of the financial asset and the entity expects the borrower to continue to replenish the collateral as necessary. If the fair value of the collateral at the reporting date is less than the amortized cost basis of the financial asset, an entity shall limit the allowance for credit losses on the financial asset to the difference between the fair value of the collateral at the reporting date and the amortized cost basis of the financial asset.

Certain reinsurance contracts require the reinsurer to continually adjust the amount of collateral securing the financial asset as a result of changes in the fair value of the collateral. An example is a clause that requires the fair value of assets in a designated trust to equal or exceed 102% of ceded reserves. If certain conditions are met, including frequency of collateral replenishment, a reinsurance contract may qualify for the collateral maintenance provisions practical expedient. [326-20-35-6]

An insurance entity may determine that the allowance for credit losses for reinsurance recoverables is zero if (1) the reinsurer is required to continually replenish the collateral securing the financial asset such that the fair value of the collateral is equal to or exceeds the reinsurance recoverable asset and (2) the insurance entity expects the reinsurer to continue to replenish the collateral as necessary. [326-20-35-6]

### **Question 17.3.10** Does the monthly or quarterly evaluation of a trust account for required collateral replenishment meet the requirement to continually adjust the amount of collateral?

**Interpretive response:** No. We believe the term 'continually' implies a frequency that would generally align with daily or weekly evaluation of a trust account for required adjustments to the amount of collateral securing the financial asset. For specific considerations related to the frequency of collateral replenishment, see Question 10.3.15.

## 17.3.50 Other insurer-specific items

Subtopic 326-20 does not prescribe a specific method for estimating expected credit losses. An entity uses its judgment to develop an approach that faithfully reflects expected credit losses for financial assets and can be applied consistently over time. As discussed in section 3.1, there is no credit loss recognition threshold and up-front loss recognition is required under Subtopic 326-20. Therefore, upon initial recognition of a financial asset in the scope of Subtopic 326-20 (e.g. premiums receivable), a credit loss expense is recognized. Methods to estimate expected credit losses are discussed in chapter 4. [326-20-55-7]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 17.3.30** What effect does the unearned premium reserve have on the estimate of expected credit losses for premiums receivable?

### Excerpt from ASC 944-605

> Short-Duration Contracts

**25-1** Premiums from short-duration contracts shall be recognized as revenue over the period of the contract in proportion to the amount of insurance protection provided. For those few types of contracts for which the period of risk differs significantly from the **contract period**, premiums shall be recognized as revenue over the period of risk in proportion to the amount of insurance protection provided. That generally results in premiums being recognized as revenue evenly over the contract period (or the period of risk, if different), except for those few cases in which the amount of insurance protection declines according to a predetermined schedule.

**Background:** Under Subtopic 326-20, an entity recognizes an allowance for expected credit losses on its premium receivable. The allowance for credit losses reduces the premium receivable to the net amount expected to be collected from the contract holder. [326-20-30-1]

Under Topic 944, an entity records a premium receivable at the inception of a short-duration insurance contract for the amount of contractual premiums due. Simultaneously, an unearned premium reserve (liability) is recorded for the portion of those contractual premiums requiring future performance (i.e. not yet earned). The unearned premium reserve is then recognized in earnings over the period of risk in proportion to the amount of insurance protection provided. [944-605-25-1]

Typically, premiums are due from the contract holder before the coverage period of the insurance contract. The premium payments may be due annually, semi-annually, quarterly or monthly. Commonly, an insurance contract includes a grace period for the contract holder to pay outstanding premium – e.g. 30 or 60 days. An entity has no future performance obligation upon cancellation – i.e. no requirement to provide future insurance coverage. Generally, an entity cancels the insurance contract upon non-payment at the end of any contractual grace period. At the cancellation date, the entity reverses any related unearned premium reserve with a correlated entry to reverse the related premium receivable.

**Interpretive response:** In estimating the allowance for credit losses, we believe an entity should consider the unearned premium reserve related to the insurance contract that is recorded under Topic 944. We believe that credit losses are recognized only on the portion of the premium receivable that exceeds (or is projected to exceed) the related unearned premium reserve that is reversed.

As a result, we believe an entity's estimation of the allowance for credit losses for a premium receivable should consider:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- the projected balance of the unearned premium reserve associated with the underlying premium receivable at the time a future credit loss is expected to occur; and
- any contractual requirements (i.e. grace period) or jurisdictional laws that extend the contract coverage (i.e. performance obligation) beyond the date that the credit loss is expected to occur. This is because that additional coverage period will reduce the amount of the unearned premium reserve to be reversed against the related premium receivable.

We believe that when the unearned premium reserve is projected to be equal to or greater than the underlying premiums receivable at the time a future credit event is expected to occur, the entity has no credit loss exposure for which an allowance for credit losses should be recognized. This is because a contract holder default before recognizing premium revenue would lead to the derecognition of the premiums receivable and related unearned premium reserve, as opposed to the recognition of a credit loss. [326-20-30-1]

## **Question 17.3.40** What is considered when assessing the collectibility of reinsurance recoverables?

### Excerpt from ASC 944-10 Glossary

**20 Glossary**

**Reinsurance**

A transaction in which a reinsurer (assuming entity), for a consideration (premium), assumes all or part of a risk undertaken originally by another insurer (ceding entity). For indemnity reinsurance, the legal rights of the insured are not affected by the reinsurance transaction and the insurance entity issuing the insurance contract remains liable to the insured for payment of policy benefits. Assumption or novation reinsurance contracts that are legal replacements of one insurer by another extinguish the ceding entity's liability to the policyholder.

### Excerpt from ASC 944-20

> Assumption Reinsurance

**40-4** Reinsurance contracts in which a ceding entity is not relieved of the legal liability to its policyholder shall not result in removal of the related assets and liabilities from the ceding entity's financial statements.

**Background:** When the entity issuing the insurance contract remains liable to the insured for payment of policy benefits because the legal rights of the insured are not affected by the reinsurance contract, it records a reinsurance recoverable for the estimated amount recoverable from the reinsurer. Generally, the reinsurance recoverable is not due from the reinsurer until the entity pays the claim on the underlying reinsured contract. [944-10 Glossary, 944-20-40-4]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The entity estimates expected credit losses of reinsurance recoverables based on the credit risk of the reinsurer. The allowance for credit losses reduces the carrying amount of the reinsurance recoverable asset to the net amount expected to be collected from the reinsurer. [326-20-30-1, 55-82]

**Interpretive response:** An entity considers relevant available information about past events, current conditions and reasonable and supportable forecasts to assess the collectibility of cash flows from the reinsurer. The entity uses this information to develop an estimate of the allowance for credit losses of reinsurance recoverables. [326-20-30-7, 30-12]

When assessing the collectibility of reinsurance recoverables, we believe the entity should consider available information, including:

- the reinsurer's external credit and claims paying ratings from reputable rating agencies;
- information from an established internal credit rating review process;
- the expected claim payment pattern and related exposure period; and
- any credit enhancements that are not freestanding (e.g. embedded letters of credit or trust accounts), funds withheld, recapture or commutation settlement provisions, and other reinsurance agreement provisions that may impact the collectibility of reinsurance recoverables.

An entity may purchase an annuity from a third party to fund future payments due on an underlying insurance contract – e.g. structured settlements. The entity may classify that annuity within reinsurance recoverables on the balance sheet. When assessing the collectibility of this reinsurance recoverable, we believe the entity should also consider any coverage available from state guaranty funds; this is because such coverage is not a freestanding contract. This coverage is not freestanding because it is available for the annuity contract purchased (i.e. it is not entered into separate and apart from the annuity contract) and is not legally detachable nor separately exercisable.

For further guidance about credit enhancement for insurance entities, see section 17.3.30.

## **Question 17.3.50** How are government established indemnification programs considered when estimating expected credit losses?

**Background:** Certain state governments have established mandatory indemnification mechanisms (indemnification programs) that require membership from all entities selling certain types of insurance in their jurisdiction. Typically, the indemnification program has an administrator that collects annual assessments from active members (i.e. insurers) based on the estimated average cost of all program members' incurred indemnifications. Typically, the insurer recognizes a receivable from the program administrator for reimbursements of qualifying claim losses and associated expenses paid in accordance with the legal requirements of the indemnification program. Statutes and regulations often allow active members to recoup their

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

assessments from underlying policyholders either through policy surcharges or premium rate adjustments.

There may be other types of government-established indemnification programs. An entity evaluates receivables from programs similar to the indemnification program to determine the allowance for credit losses to be recognized.

**Interpretive response:** We believe an entity should evaluate each receivable related to a government-established indemnification program to determine the allowance for credit losses to be recognized. This evaluation is performed whether or not the government-established indemnification program is accounted for as reinsurance.

When estimating the allowance for credit losses, we believe an entity should consider the program's features, including:

- whether the indemnification program and its administrators have the right and capacity to assess its members for the program's expected indemnification obligations;
- whether members are assessed for the full amount of losses and loss expenses expected to be incurred each year, and whether those assessments are fully passed along to the underlying policyholders – i.e. if the assessments are not fully passed along to policyholders, the insurer retains credit exposure;
- program members' credit loss experience since program inception and whether losses are expected based on current conditions and reasonable and supportable forecasts;
- historical and expected future performance of the program's administration and servicing functions, including billing and collection of assessments and indemnification payments to members; and
- evaluation of available information regarding the program's financial condition and whether financial resources are available to support the program's obligations.

We believe an entity should monitor the potential for future legislation or other changes that could impact the nature of the program, result in the indemnification not being provided, or change the expectation of potential nonpayment to the extent that they could impact the amount of expected credit losses.

If there is an expectation that a financial asset qualifies for the zero loss exception, an entity is not required to estimate or recognize an allowance for credit losses. For discussion about the zero loss expectation exception, see section 8.2.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 18. Specific considerations for commercial entities and trade receivables

## Detailed contents

Item significantly updated in this edition: #

**18.1 How the standard works**

**18.2 Topic 606 assets in the scope of Subtopic 326-20**

18.2.10 Overview

**18.3 Estimating credit losses for Topic 606 assets**

18.3.10 Overview#

**Questions**

**Question 18.3.10** Can an entity use an aging schedule to estimate its allowance for credit losses for short-term trade receivables?#

**Question 18.3.20** How does an entity estimate expected credit losses for trade receivables recognized under Topic 606 when the associated revenue has not been recognized?

**Question 18.3.30** Does an entity estimate expected credit losses on sales tax receivables from customers?

**18.4 Purchase of financial assets**

18.4.10 Overview#

**Example**

**Example 18.4.10** Acquisition of a company with trade receivables#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 18.1 How the standard works

Topic 326 applies to all entities, including commercial entities, if they hold financial assets in its scope. The scope of Subtopic 326-20, which is described in more detail in chapter 2, specifically includes receivables that result from revenue transactions in the scope of Topic 606.

The following chart contains references to other chapters in this publication that address common activities of commercial entities:

| Type of activities | Relevant chapters |
|---|---|
| Lending activities | 3 - 8 |
| Investments in HTM debt securities | 3 - 8 |
| Practical expedients and simplifications – current accounts receivable and contract assets | 10 (section 10.4) |
| Investments in AFS debt securities | 19 |
| Other investments in equity method investees | 15 |
| Guarantees | 14 |

The commercial entities that are most likely to be significantly affected by Topic 326 are those that:

- engage in lending activities, exclusive of accounts receivable arrangements;
- invest in debt securities that are classified as either HTM or AFS; or
- provide guarantees that create off-balance sheet credit exposure, but are not accounted for as either derivatives or insurance.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 18.2 Topic 606 assets in the scope of Subtopic 326-20

## 18.2.10 Overview

### Excerpt from ASC 606-10

**45-3** If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a **contract asset**, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for credit losses in accordance with Subtopic 326-20 on financial instruments measured at amortized cost. A credit loss of a contract asset shall be measured, presented, and disclosed in accordance with Subtopic 326-20 (see also paragraph 606-10-50-4(b)).

**45-4** A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with Topic 310 and Subtopic 326-20. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Subtopic 326-20 and the corresponding amount of **revenue** recognized shall be presented as a credit loss expense.

**20 Glossary**

**Contract Asset**

An entity's right to consideration in exchange for goods or services that the entity has transferred to a **customer** when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

Receivables that result from revenue transactions in the scope of Topic 606 include contract assets as well as trade receivables, both of which are in the scope of Subtopic 326-20. [606-10-45-3, 45-4]

Topic 606 requires an entity to estimate credit losses for both receivables and contract assets under Subtopic 326-20. [326-20-15-2(a)(3), 606-10-45-3 – 45-4]

- Receivables are unconditional rights to consideration. A right is unconditional if only the passage of time is required before payment becomes due.
- Contract assets are rights to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditional on something other than the passage of time.

For discussion of Topic 606, see KPMG Handbook, Revenue recognition.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 18.3 Estimating credit losses for Topic 606 assets

## 18.3.10 Overview#

As further discussed in chapter 3, there is no credit loss recognition threshold and up-front loss recognition is required under Subtopic 326-20. Therefore, upon initial recognition of the contract asset or trade receivable, a credit loss expense is recognized.

Contract assets and trade receivables frequently have a relatively short duration. It may be acceptable to estimate credit losses on trade receivables using methods such as aging schedules.

Subtopic 326-20 also provides two simplifications that can be used when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers). Those simplifications are summarized below; see further guidance in section 10.4.

| Simplification | Summary |
|---|---|
| **Practical expedient to assume current conditions do not change**<br>See section 10.4.20. | Any entity is permitted to assume current conditions as of the balance sheet date do not change for the remaining life of current accounts receivable and contract assets. |
| **Accounting policy to consider subsequent collection activity**<br>See section 10.4.30. | An entity that is not a PBE is permitted to consider collection activity after the balance sheet date if it has also elected the practical expedient to assume current conditions have not changed. |

### **Question 18.3.10** Can an entity use an aging schedule to estimate its allowance for credit losses for short-term trade receivables?#

**Interpretive response:** Yes, provided its process for developing loss rates using an aging schedule is consistent with the guidance on developing historical loss experience in Subtopic 326-20, and necessary adjustments are made to those loss rates to reflect current economic conditions and reasonable and supportable forecasts of future economic conditions.

Under Subtopic 326-20 the starting point for estimating the allowance for doubtful accounts is the entity's historical loss experience. An entity using aging schedules should ensure that the historical periods used to develop the loss rates in the aging schedule are consistent with the guidance in chapter 7.

Historical credit loss experience is adjusted for differences in asset-specific risk characteristics, current economic conditions, and reasonable and supportable forecasts of future economic conditions. An entity therefore considers whether there are:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- differences in the nature of the trade receivables that existed in the historical period and those that exist at the reporting date; and [326-20-30-8]
- differences in economic conditions between the period used to develop the historical loss rates and those that exist at the reporting date and over the reasonable and supportable forecast period. [326-20-30-8 – 30-9]

For example, the trade receivables in the historical period might have been of different credit quality (i.e. the financial condition of the entity's customers may have changed) or a different duration (i.e. 30-day receivables versus 60-day receivables). For more information on adjusting historical loss experience for differences in asset-specific risk characteristics, see section 7.3.

Under Subtopic 326-20, an entity considers reasonable and supportable forecasts of future economic conditions. We believe that many entities may conclude that their trade receivables are so short-term in nature that future changes in economic conditions will not have a significant effect on the estimate; however, each entity needs to assess its specific facts and circumstances at each reporting date. For more information on adjusting historical loss experience for differences in economic conditions, see section 7.3.20. [326-20-30-8 – 30-9]

See also section 10.4 about two simplifications that can be used when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606.

## Excerpt from ASC 326-20

• > Example 5: Estimating Expected Credit Losses for Trade Receivables Using an Aging Schedule

**55-37** This Example illustrates one way an entity may estimate expected credit losses for trade receivables using an aging schedule.

**55-38** Entity E manufactures and sells products to a broad range of customers, primarily retail stores. Customers typically are provided with payment terms of 90 days with a 2 percent discount if payments are received within 60 days. Entity E has tracked historical loss information for its trade receivables and compiled the following historical credit loss percentages:

a. 0.3 percent for receivables that are current
b. 8 percent for receivables that are 1–30 days past due
c. 26 percent for receivables that are 31–60 days past due
d. 58 percent for receivables that are 61–90 days past due
e. 82 percent for receivables that are more than 90 days past due.

**55-39** Entity E believes that this historical loss information is a reasonable base on which to determine expected credit losses for trade receivables held at the reporting date because the composition of the trade receivables at the reporting date is consistent with that used in developing the historical credit-loss percentages (that is, the similar risk characteristics of its customers and its lending practices have not changed significantly over time). However, Entity E has determined that the current and reasonable and supportable forecasted

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

economic conditions have improved as compared with the economic conditions included in the historical information. Specifically, Entity E has observed that unemployment has decreased as of the current reporting date, and Entity E expects there will be an additional decrease in unemployment over the next year. To adjust the historical loss rates to reflect the effects of those differences in current conditions and forecasted changes, Entity E estimates the loss rate to decrease by approximately 10 percent in each age bucket. Entity E developed this estimate based on its knowledge of past experience for which there were similar improvements in the economy.

**55-40** At the reporting date, Entity E develops the following aging schedule to estimate expected credit losses.

| Past-Due Status | Amortized Cost Basis | Credit Loss Rate | Expected Credit Loss Estimate |
|---|---|---|---|
| Current | $5,984,698 | 0.27% | $16,159 |
| 1-30 days past due | 8,272 | 7.2% | 596 |
| 31-60 days past due | 2,882 | 23.4% | 674 |
| 61-90 days past due | 842 | 52.2% | 440 |
| More than 90 days past due | 1,100 | 73.8% | 812 |
| | **$5,997,794** | | **$18,681** |

## **Question 18.3.20** How does an entity estimate expected credit losses for trade receivables recognized under Topic 606 when the associated revenue has not been recognized?

**Background:** In some cases, an entity has an unconditional right to consideration (i.e. a receivable) before it has transferred goods or services to the customer. In these arrangements, the entity may have the intent and ability to refuse to deliver those goods or services if the customer defaults on its payment(s) even if the entity does not have the unconditional right to cancel the contract.

For example, an entity might enter into a non-cancellable contract to provide maintenance that entitles the entity to bill and collect the consideration before the service period begins. The entity recognizes a receivable and corresponding contract liability with no effect on net income before the service is transferred to the customer. If the customer defaults on its payment, the entity can refuse to provide or stop providing maintenance services. [606-10-45-2]

**Interpretive response:** We believe an allowance for expected credit losses should be estimated for a trade receivable only to the extent that the related revenue has been recognized. When an entity has recognized a receivable and a corresponding contract liability with no income statement impact, it has no credit loss exposure for which an allowance for expected credit losses should be recognized. This is because a customer default before recognizing revenue would lead to the derecognition of the trade receivable and related contract liability, as opposed to the recognition of a credit loss.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 18.3.30** Does an entity estimate expected credit losses on sales tax receivables from customers?

**Background:** When an entity recognizes a receivable related to a sale of goods or services, the receivable may include amounts to be collected from the customer pertaining to sales tax imposed by a taxing authority. In those situations, the entity also recognizes a corresponding liability to remit sales tax to the taxing authority. In some cases, the entity is not obligated to pay amounts to the taxing authority if the customer defaults on the receivable.

**Interpretive response:** It depends. We believe an allowance for expected credit losses should be estimated for sales tax receivables from customers only to the extent the entity is obligated to remit to the taxing authority amounts not actually collected from the customer.

When an entity is not obligated to remit amounts not actually collected, the entity has no credit loss exposure for which an allowance for credit losses should be recognized. A customer default leads to derecognition of the sales tax receivable and the related liability to the taxing authority, and not the recognition of a credit loss.

## 18.4 Purchase of financial assets

### 18.4.10 Overview#

*This chapter is written as if ASU 2025-08, which introduced the concept of purchased seasoned loans (PSLs), is fully effective. Because the ASU introduces significant and pervasive changes to the accounting for acquired financial assets, readers should be aware that certain requirements described here may not yet be effective for entities that have not elected early adoption of the ASU. See section 25.3 for transition and effective dates guidance for ASU 2025-08.*

When an entity acquires a financial asset in the scope of Topic 326, it determines whether, as of the date of the acquisition, the asset has experienced a more-than-insignificant deterioration in credit quality since origination or issuance. If there has been a more-than-insignificant deterioration in credit quality, based on the acquirer's assessment, the asset is identified as a PCD asset. If the acquired financial asset is not a PCD asset, the entity next evaluates whether the acquired financial asset meets the definition of a PSL. Gross-up accounting applies to PCD assets and PSLs. For additional discussion on the scope and gross-up accounting for PCD assets and PSLs, see chapter 12.

When an entity acquires financial assets that are neither PCD assets nor PSLs, it recognizes:

- the acquired financial asset at fair value; and
- an allowance for remaining lifetime expected credit losses.

Subtopic 326-20 precludes an entity from using a purchase discount to offset its expectation of credit losses (see Question 12A.2.40). Instead, an entity

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

estimates the effect that the discount will have on the expected credit losses of the amortized cost basis, as illustrated in Examples 4.3.10 and 4.3.20. The purchase discount is accreted into interest income. [326-20-30-5]

In addition, an entity recognizes a writeoff (full or partial) of financial assets in the period in which they are deemed uncollectible. [326-20-35-8]

## **Example 18.4.10** Acquisition of a company with trade receivables#

ABC Corp. acquires DEF Corp. in a business combination, paying $2,000,000 on January 1, Year 1.

The following are the fair values of the assets acquired and liabilities assumed. In this example, deferred income taxes are ignored.

| | |
|---|---|
| Cash | 200,000 |
| Trade receivables arising from transactions accounted for under Topic 606 | 900,000 |
| Land, building, furniture and equipment | 2,000,000 |
| Long-term debt | (1,500,000) |

ABC determines that the entire portfolio consists of trade receivables that have not experienced a more-than-insignificant deterioration in credit quality since origination. Therefore, PCD accounting does not apply. Further, PSL accounting does not apply to the trade receivables.

ABC uses a method other than the discounted cash flow method (e.g. loss-rate method) to estimate the credit losses. The trade receivables have an estimated life of less than 90 days such that they will be paid off in the same reporting period as the acquisition.

ABC determines the following amounts for the trade receivables:

- Total remaining unpaid amount: $1,000,000
- Fair value: $900,000
- Amount expected to be collected: $950,000.

ABC records the following journal entry to account for the acquisition of DEF.

| | **Debit** | **Credit** |
|---|---|---|
| Cash (acquired) | 200,000 | |
| Trade receivables[1] | 1,000,000 | |
| Land, building, furniture and equipment | 2,000,000 | |
| Goodwill | 400,000 | |
| Long-term debt | | 1,500,000 |
| Trade receivables – discount | | 100,000 |
| Cash (consideration) | | 2,000,000 |
| *To record acquisition of DEF.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Note:

1. The trade receivables are recorded at the fair value of $900,000. For illustrative purposes, the total unpaid amount of $1,000,000 and the purchase discount of $100,000 are shown gross.

ABC calculates its allowance for credit losses related to the trade receivables as $50,000: $1,000,000 (contractual amounts due) – $950,000 (amount expected to be collected). ABC may not offset the allowance of $50,000 by the purchase discount of $100,000. Therefore, ABC recognizes the initial estimate of expected losses on the acquired trade receivables through net income.

| | Debit | Credit |
|---|---|---|
| Credit loss expense | 50,000 | |
| Allowance for credit losses | | 50,000 |
| *To record estimate of expected credit losses on trade receivables.* | | |

During the reporting period, ABC determines that $50,000 is uncollectible, collects the unpaid amount of $950,000 and accretes the $100,000 discount. ABC does not have a nonaccrual policy. Nonaccrual policies, when applicable, may affect the recognition of interest income for specific trade receivables that have a credit loss.

| | Debit | Credit |
|---|---|---|
| Trade receivables - discount | 100,000 | |
| Interest income | | 100,000 |
| *To record accretion of discount.* | | |
| Allowance for credit losses | 50,000 | |
| Trade receivables | | 50,000 |
| *To record writeoff of uncollectible amount.* | | |
| Cash | 950,000 | |
| Trade receivables | | 950,000 |
| *To record collection of cash for unpaid amount.* | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 19. AFS debt securities

## Detailed contents

**19.1 How the standard works**

**19.2 Scope of Subtopic 326-30**

19.2.10 Overview

**Questions**

**Question 19.2.10** Why does Topic 326 include a separate model for AFS debt securities?

**Question 19.2.20** Is a forward or option to purchase AFS debt securities in the scope of Subtopic 326-30?

**19.3 Determining whether a security is impaired**

19.3.10 Overview

19.3.20 Assessing whether a credit loss exists

**Questions**

**Question 19.3.05** When does an entity recognize in earnings decreases in an AFS debt security's fair value due to changes in foreign currency rates?

**Question 19.3.10** Can a qualitative assessment be performed to determine whether a credit loss exists?

**Question 19.3.20** What factors does an entity consider when assessing whether a credit loss exists?

**19.4 Estimating the allowance for credit losses**

19.4.10 Overview

19.4.20 Specific considerations for variable rate securities

19.4.30 Accrued interest receivable

**Questions**

**Question 19.4.05** What information does an entity consider when estimating a credit loss?

**Question 19.4.10** How does an entity determine a best estimate of credit losses when measuring expected credit losses?

**Question 19.4.15** What considerations are relevant in selecting a discount rate used to determine the present value of expected cash flows?

**Question 19.4.20** Does a decrease in expected cash flows solely due to an increase in expected prepayments result in a credit loss?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 19.4.25** How are credit losses for a forward contract to purchase AFS debt securities accounted for?

**Question 19.4.30** What does an entity consider when determining the EIR for a variable rate debt security?

**Examples**

**Example 19.4.02** Single most-likely cash flow approach

**Example 19.4.05** Probability-weighted cash flow approach

**Example 19.4.10** Impairment of AFS securities

**Example 19.4.15** Forward contract to purchase PCD AFS debt securities

**19.5 Accounting for a credit loss**

19.5.10 Overview

19.5.20 Credit losses when an entity intends to sell, or more likely than not will be required to sell, a debt security

**Questions**

**Question 19.5.10** How does an entity determine whether it has an intent to sell a debt security?

**Question 19.5.20** How does an entity determine whether it has an intent to sell if it has decided to sell a debt security only upon the occurrence of a contingent event?

**Question 19.5.30** If a decision to sell has not yet been made, does an entity need to assess the likelihood that it may sell a debt security?

**Question 19.5.40** Does use of a portfolio manager impact how an entity determines if it has an intent to sell a debt security?

**Question 19.5.50** How does an entity determine whether it will more likely than not be required to sell a debt security?

**Question 19.5.60** What are the documentation considerations related to the intent or requirement to sell assertions?

**Question 19.5.70** What does an entity consider if it sells a security at a loss shortly after the reporting date but had not previously asserted an intent to sell the security?

**Example**

**Example 19.5.10** Accounting for impairment when it is more likely than not that an entity will be required to sell the security before recovery

**19.6 Accounting for a debt security subsequent to credit impairment**

19.6.10 Overview

19.6.20 Accounting subsequent to a writedown to fair value

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Questions**

**Question 19.6.10** Does an entity continue to accrue interest income for AFS debt securities with credit losses?

**Question 19.6.20** Does an entity have to account for writeoffs under Subtopic 326-30?

**Question 19.6.30** Must an entity write off accrued interest receivable as a deduction from the allowance for credit losses?

**Question 19.6.40** How are decreases in expected cash flows from an AFS debt security accounted for when an entity no longer intends to sell the security?

**Example**

**Example 19.6.10** Subsequent accounting for impairment of individual AFS securities

**19.7 Comparison of accounting for debt securities as AFS and HTM**

**19.8 Purchased AFS securities with credit deterioration**

19.8.10 Overview

19.8.20 Identifying purchased AFS securities with credit deterioration

19.8.30 Initially measuring purchased AFS securities with credit deterioration

19.8.40 Subsequently measuring purchased AFS securities with credit deterioration

**Questions**

**Question 19.8.10** Are there different concepts for assessing whether AFS and HTM debt securities qualify for PCD accounting?

**Question 19.8.20** Can an entity place a purchased AFS debt security with credit deterioration on nonaccrual status?

**Example**

**Example 19.8.10** PCD AFS debt securities – initial measurement

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 19.1 How the standard works

The guidance in Subtopic 326-30 applies to all AFS debt securities, including loans accounted for as AFS debt securities. Although Subtopic 326-30 replaced the legacy US GAAP OTTI model with a credit loss model, it retained an essential aspect of that model – that entities are required to determine the amount of credit losses, if any, when securities are impaired. An AFS debt security is impaired when the fair value declines below its amortized cost basis.

Subtopic 326-30 requires AFS debt securities to be assessed at the individual security level. A decline in fair value is due to a credit loss to the extent the entity does not expect to recover the amortized cost basis. If an entity does not intend to sell the debt security and it is not more likely than not that it will be required to sell the security before recovery of the amortized cost basis, only the decline in fair value due to a credit loss is recognized through net income. Any portion of the decline that is due to factors other than a credit loss is recognized in other comprehensive income, net of applicable taxes.

Credit losses are recognized using an allowance approach, with amounts written off when deemed uncollectible or when the entity intends to sell (or more likely than not will be required to sell) the debt security before recovery of the amortized cost basis. Reversals of credit losses are recognized immediately. However, the allowance for credit losses cannot be negative.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 19.2 Scope of Subtopic 326-30

## 19.2.10 Overview

### Excerpt from ASC 326-30

> Entities

**15-1** The guidance in this Subtopic applies to all entities.

> Instruments

**15-2** The guidance in this Subtopic applies to **debt securities** classified as **available-for-sale securities**, including **loans** that meet the definition of *debt securities* and are classified as available-for-sale securities.

The guidance in Subtopic 326-30 applies to all AFS debt securities, including loans accounted for as AFS debt securities. The scope includes AFS debt securities purchased with credit deterioration (PCD), but the Subtopic contains separate guidance for these securities (see section 19.8). [326-30-15-2]

### **Question 19.2.10** Why does Topic 326 include a separate model for AFS debt securities?

**Interpretive response:** The fair value measurement attribute for AFS debt securities necessitates a credit loss model separate from the model in Subtopic 326-20 because an entity may realize the value of the securities either through collection of contractual cash flows or through sales of the securities. [ASU 2016-13.BC81]

Subtopic 326-20's expected credit loss model is designed to estimate credit losses over the contractual life of a financial asset. The FASB decided that this model may not be suitable for financial assets that an entity may not intend to hold to maturity. [ASU 2016-13.BC80]

Lastly, the amount of credit losses that can be realized on AFS debt securities is limited to the amount that fair value is less than amortized cost; this is because an entity can sell the securities at fair value to avoid realization of credit losses. The ability to limit the credit losses means the credit loss model for AFS debt securities needs to be applied at the individual instrument level. Therefore, the collective evaluation in Subtopic 326-20 is not appropriate for these securities. [ASU 2016-13.BC81]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 19.2.20** Is a forward or option to purchase AFS debt securities in the scope of Subtopic 326-30?

### Excerpt from ASC 815-10

**Certain Contracts on Debt and Equity Securities**

> Instruments

**15-141** The guidance in the Certain Contracts on Debt and Equity Securities Subsections applies only to those forward contracts and purchased options having all of the following characteristics:

a. The contract is entered into to purchase securities that will be accounted for under either Topic 320 or Topic 321.
b. The contract's terms require physical settlement of the contract by delivery of the securities.
c. The contract is not a **derivative instrument** otherwise subject to this Subtopic.
d. The contract, if a purchased option, has no intrinsic value at acquisition.

**25-17** Forward contracts and purchased options on debt securities within the scope of this Subsection (see the Certain Contracts on Debt and Equity Securities Subsection of Section 815-10-15) shall, at inception, be designated as held to maturity, available for sale, or **trading** in a manner consistent with the accounting prescribed by Topic 320 for debt securities. Such forward and option contracts are not eligible to be hedging instruments.

**35-5** Forward contracts and purchased options on debt securities within the scope of this Subsection shall be measured subsequently according to their initial classification as follows: …

b. Available for sale:
    1. Changes in the fair value of the forward contract or purchased option shall be recognized as part of the separate component of shareholders' equity under Topic 320 as they occur. Credit losses on the underlying securities in a forward contract shall be recorded through an allowance for credit losses in accordance with Subtopic 326-30 on measuring credit losses on available-for-sale debt securities. Credit losses on the underlying securities in a purchased option shall be recorded through an allowance for credit losses in accordance with Subtopic 326-30 and shall be limited by the amount of the option premium.
    2. Debt securities purchased under a forward contract shall be recorded at their fair values at the settlement date.
    3. Debt securities purchased by exercising an option shall be recorded at the option strike price plus the fair value of the option at the exercise date.
    4. If the option expires worthless and the same debt security is purchased in the market, the security shall be recorded at its market price plus any remaining carrying amount for the option premium.

**Background:** A forward or option to purchase debt securities is in the scope of Subtopic 815-10 if it meets the following conditions: [815-10-15-141, 815-10-25-17]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- it is not accounted for as a derivative under Topic 815;
- the underlying securities will (when purchased) be subject to Topic 320 (investments in debt securities);
- the contract's terms require physical settlement; and
- if the contract is a purchase option contract, it has no intrinsic value at acquisition.

**Interpretive response:** Yes, for a forward and option that meets the conditions in the background. A forward or option to purchase AFS debt securities (including debt securities deemed PCD) that is in the scope of Subtopic 815-10 is in the scope of Subtopic 326-30. Credit losses on the securities underlying the contract are recorded through an allowance for credit losses. [815-10-35-5(b)]

For accounting considerations related to forwards and options to purchase debt securities, see section 2.3.50 of KPMG Handbook, Derivatives and hedging.

## 19.3 Determining whether a security is impaired

### Excerpt from ASC 326-30

> Impairment of Individual Available-for-Sale Securities

• > Identifying and Accounting for Impairment

**35-1** An investment is impaired if the **fair value** of the investment is less than its **amortized cost basis**.

**35-1A** An entity shall not consider a basis adjustment related to an existing portfolio layer method hedge designated in accordance with paragraph 815-20-25-12A when measuring impairment of the individual investments or individual beneficial interest included in a closed portfolio hedged using the portfolio layer method

**35-2** For individual **debt securities** classified as **available-for-sale securities**, an entity shall determine whether a decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. An entity shall record impairment relating to credit losses through an allowance for credit losses. However, the allowance shall be limited by the amount that the fair value is less than the amortized cost basis. Impairment that has not been recorded through an allowance for credit losses shall be recorded through other comprehensive income, net of applicable taxes. An entity shall consider the guidance in paragraphs 326-30-35-6 and 326-30-55-1 through 55-4 when determining whether a credit loss exists.

**35-4** Impairment shall be assessed at the individual security level (referred to as an investment). The impairment assessment of the individual securities or individual beneficial interest in a closed portfolio hedged using the portfolio layer method shall not consider the basis adjustment related to an existing portfolio layer method hedge. Individual security level means the level and method of aggregation used by the reporting entity to measure realized and unrealized gains and losses on its debt securities. (For example, debt securities bearing the same Committee on Uniform Security Identification Procedures

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

[CUSIP] number that were purchased in separate trade lots may be aggregated by a reporting entity on an average cost basis if that corresponds to the basis used to measure realized and unrealized gains and losses for the debt securities.) Providing a general allowance for an unidentified impairment in a portfolio of debt securities is not appropriate.

**35-5** An entity shall not combine separate contracts (a debt security and a guarantee or other credit enhancement) for purposes of determining whether a debt security is impaired or can contractually be prepaid or otherwise settled in such a way that the entity would not recover substantially all of its cost.

## 19.3.10 Overview

An AFS debt security is impaired when its fair value declines below its amortized cost basis. This decline is due to a credit loss to the extent the entity does not expect to recover the amortized cost basis. A credit loss is recognized through net income. Any portion of the decline that is due to factors other than a credit loss – such as changes in market interest rates – is recognized in other comprehensive income (OCI), net of applicable taxes. [326-30-35-1, 35-2]

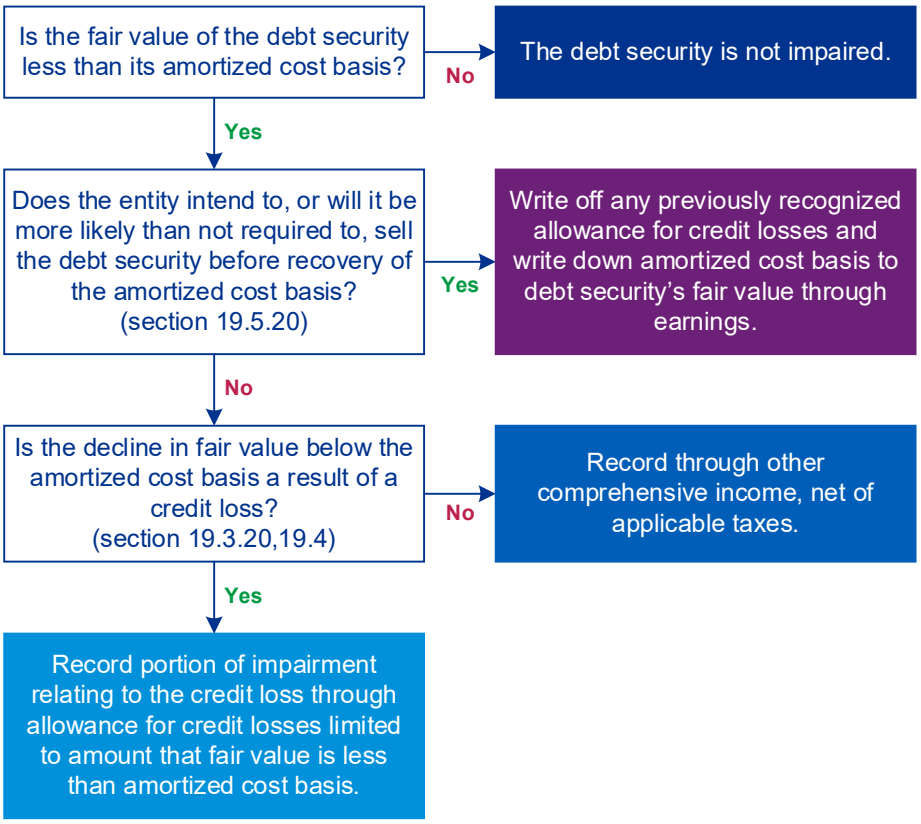
Impairment is determined on an individual security basis. Therefore, an AFS debt security cannot be combined with other securities to determine whether the collective securities are impaired. Similarly, it cannot be considered for impairment with any guarantees or other credit enhancements that are evidenced by separate contracts. [326-30-35-4 – 35-5]

Individual security means the level and method of aggregation used by the entity to measure realized and unrealized gains and losses on its debt securities. For example, debt securities with the same Committee on Uniform Security Identification Procedures (CUSIP) numbers that were purchased separately may be aggregated using an average cost basis if that is how an entity measures realized and unrealized gains and losses. [326-30-35-4]

Section 19.3.20 explains how to determine if a decline in a security's fair value below the amortized cost basis is due to a credit loss.

The following decision tree provides an overview of the process an entity undertakes each reporting period for its AFS debt securities.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.




## **Question 19.3.05** When does an entity recognize in earnings decreases in an AFS debt security's fair value due to changes in foreign currency rates?

**Background:** Changes in fair value of an AFS debt security due to changes in foreign currency rates are not the result of a credit loss. Therefore, such changes are not recognized through an allowance for credit losses. [326-30-35-1 – 35-2]

**Interpretive response**: It depends.

When an entity intends to sell (or more likely than not will be required to sell) an AFS debt security before recovery of the security's amortized cost basis, the entity recognizes the difference between fair value and amortized cost in net income and as a writedown of the amortized cost basis.

When an entity does not intend to sell (and it is not more likely than not that the entity will be required to sell) an AFS debt security, we believe either of the following approaches, consistently applied, is acceptable: [326-30-35-10, 320-10-35-1(b), 450-20-25-2, TRG 11-18.18]

- **Recognize losses only when they are realized**. As amended by the credit losses standard, Subtopic 320-10 (investments – debt securities) indicates that changes in fair value that are not recorded in the allowance for credit losses are recognized in AOCI. Unless the entity intends to sell (or will

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

more likely than not be required to sell) the security, those changes generally are recognized in earnings when realized (e.g. security matures).

- **Recognize losses when it is *probable* they will be ultimately realized**. We believe an entity is permitted (but not required) to apply the guidance in Subtopic 450-20 (loss contingencies) to unrealized losses on AFS debt securities that are due to changes in foreign currency rates. Under that guidance, an entity would recognize a loss in earnings when it is probable that a loss will be ultimately realized due to changes in foreign currency rates of an AFS debt security.

  For example, assume an entity owns an AFS debt security whose value has significantly decreased due to changes in foreign exchange rates since acquisition. Also assume the entity does not intend to sell (and it is not more likely than not the entity will be required to sell) the security before it matures. If the entity determines it is probable the decrease in value will not be recovered before the security's maturity, the entity would recognize the unrealized loss due to changes in foreign currency rates in net income.

## 19.3.20 Assessing whether a credit loss exists

### Excerpt from ASC 326-30

• • > Impairment in Earnings and Other Comprehensive Income

**35-6** In assessing whether a credit loss exists, an entity shall compare the present value of cash flows expected to be collected from the security with the amortized cost basis of the security. If the present value of cash flows expected to be collected is less than the amortized cost basis of the security, a credit loss exists and an allowance for credit losses shall be recorded for the credit loss, limited by the amount that the **fair value** is less than amortized cost basis. Credit losses on an impaired security shall continue to be measured using the present value of expected future cash flows.

**35-7** In determining whether a credit loss exists, an entity shall consider the factors in paragraphs 326-30-55-1 through 55-4 and use its best estimate of the present value of cash flows expected to be collected from the **debt security**. One way of estimating that amount would be to consider the methodology described in paragraphs 326-30-35-8 through 35-10. Briefly, the entity would discount the expected cash flows at the **effective interest rate** implicit in the security at the date of acquisition.

• > Information Considered When Estimating Credit Losses

**55-1** There are numerous factors to be considered in determining whether a credit loss exists. The length of time a security has been in an unrealized loss position should not be a factor, by itself or in combination with others, that an entity would use to conclude that a credit loss does not exist. The following list is not meant to be all inclusive. All of the following factors should be considered:

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

a. The extent to which the **fair value** is less than the **amortized cost basis**
b. Adverse conditions specifically related to the security, an industry, or geographic area; for example, changes in the financial condition of the issuer of the security, or in the case of an asset-backed **debt security**, changes in the financial condition of the underlying **loan** obligors. Examples of those changes include any of the following:
    1. Changes in technology
    2. The discontinuance of a segment of the business that may affect the future earnings potential of the issuer or underlying loan obligors of the security
    3. Changes in the quality of the credit enhancement.
c. The payment structure of the debt security (for example, nontraditional loan terms as described in paragraphs 825-10-55-1 through 55-2) and the likelihood of the issuer being able to make payments that increase in the future
d. Failure of the issuer of the security to make scheduled interest or principal payments
e. Any changes to the rating of the security by a rating agency.

Subtopic 326-30 provides guidance on how to assess, either quantitatively or qualitatively, whether a credit loss exists when the fair value of an AFS debt security is below its amortized cost basis at the reporting date.

An entity determines whether a credit loss exists only if the security is impaired – i.e. if the security's fair value is less than the amortized cost. [326-30-35-1]

## **Question 19.3.10** Can a qualitative assessment be performed to determine whether a credit loss exists?

**Interpretive response:** Yes. Subtopic 326-30 requires an entity to determine whether it will recover the entire amortized cost basis of an impaired debt security – i.e. any debt security with a fair value below amortized cost – by comparing: [326-30-35-6]

- the best estimate of the present value of cash flows expected to be collected from the security; with
- the amortized cost basis of the security.

Based on an assessment of the qualitative factors in paragraphs 326-30-55-1 to 55-4, an entity may determine that it expects to receive all of the contractual cash flows from an impaired debt security. For example, it may be evident that a decrease in fair value below amortized cost is caused by factors such as an increase in market interest rates or liquidity factors – and not associated with any credit concerns of the issuer of the debt security.

If an entity's best estimate is that it will receive all of the contractual cash flows from an impaired debt security when contractually due, the present value of the expected future cash flows will equal the amortized cost basis of the debt security. In that case, we believe an entity could conclude that a credit loss does not exist without performing a quantitative assessment of the present value of expected future cash flows to be collected and comparing it to the amortized cost basis of the impaired debt security.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

When this conclusion is reached qualitatively, we believe an entity should document:

- the basis for concluding that it will receive all of the contractual cash flows from an impaired debt security when contractually due; and
- that a net present value calculation of the cash flows expected to be collected would therefore result in an amount equal to the amortized cost basis of the debt security.

### **Question 19.3.20** What factors does an entity consider when assessing whether a credit loss exists?

**Interpretive response:** Factors that an entity considers when assessing whether a credit loss exists include but are not limited to: [326-30-55-1]

- the extent to which the fair value is less than the amortized cost;
- adverse conditions related to the security, an industry or geographic area (e.g. changes in the financial condition of the issuer or the security (or underlying loan obligors for asset-backed securities));
- the payment structure of the debt security and likelihood of the issuer being able to make payments that increase in the future;
- failure of the issuer to make scheduled interest or principal payments; and
- any changes to the rating of the security by a rating agency.

The FASB decided to prohibit an entity from considering the length of time that the fair value of an AFS debt security has been less than its amortized cost basis. Further, in determining whether a credit loss exists, while not specifically prohibited, we believe an entity should not consider the historical and implied volatility and recoveries or additional declines in the fair value of an AFS debt security after the reporting date. [ASU 2016-13.BC82, 326-30-55-1]

## 19.4 Estimating the allowance for credit losses

### Excerpt from ASC 326-30

• • > Impairment in Earnings and Other Comprehensive Income

**35-7A** As an accounting policy election for each major security type of debt securities classified as available-for-sale securities, an entity may adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments.

**35-8** The estimates of expected future cash flows shall be the entity's best estimate based on past events, current conditions, and on reasonable and supportable forecasts. Available evidence shall be considered in developing the estimate of expected future cash flows. The weight given to the information

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

used in the assessment shall be commensurate with the extent to which the evidence can be verified objectively. If an entity estimates a range for either the amount or timing of possible cash flows, the likelihood of the possible outcomes shall be considered in determining the best estimate of expected future cash flows.

**35-9** Available information would include existing environmental factors, for example, existing industry, geographical, economic, and political factors that are relevant to the collectibility of that debt security.

• > Information Considered When Estimating Credit Losses

**55-2** An entity should consider available information relevant to the collectibility of the security, including information about past events, current conditions, and reasonable and supportable forecasts, when developing the estimate of cash flows expected to be collected. That information should include all of the following:

a. The remaining payment terms of the security
b. Prepayment speeds
c. The financial condition of the issuer(s)
d. Expected defaults
e. The value of any underlying collateral.

**55-3** To achieve the objective in paragraph 326-30-55-2, the entity should consider, for example, all of the following to the extent they influence the estimate of expected cash flows on a security:

a. Industry analyst reports and forecasts
b. Credit ratings
c. Other market data that are relevant to the collectibility of the security

**55-4** An entity also should consider how other credit enhancements affect the expected performance of the security, including consideration of the current financial condition of the guarantor of a security (if the guarantee is not a separate contract as discussed in paragraph 326-30-35-5), the willingness of the guarantor to pay, and/or whether any subordinated interests are capable of absorbing estimated losses on the loans underlying the security. The remaining payment terms of the security could be significantly different from the payment terms in prior periods (such as for some securities backed by nontraditional loans; see paragraph 825-10-55-1). Thus, an entity should consider whether a security backed by currently performing loans will continue to perform when required payments increase in the future (including balloon payments). An entity also should consider how the value of any collateral would affect the expected performance of the security. If the fair value of the collateral has declined, an entity should assess the effect of that decline on its ability to collect the balloon payment.

## 19.4.10 Overview

Subtopic 326-30 requires an entity to use a discounted cash flow method to estimate a credit loss. Therefore, an entity determines whether it will recover

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

the entire amortized cost basis of an impaired debt security – i.e. any debt security with a fair value below amortized cost – by comparing: [326-30-35-6]

- the present value of cash flows expected to be collected from the security; with
- the amortized cost basis of the security.

The estimate of expected future cash flows is the entity's best estimate based on past events, current conditions, and reasonable and supportable forecasts. [326-30-35-8]

## **Question 19.4.05** What information does an entity consider when estimating a credit loss?

**Interpretive response:** When estimating a credit loss, an entity considers available information relevant to collectibility, including information about past events, current conditions and reasonable and supportable forecasts. Available information relevant to collectibility includes existing environmental factors, such as existing industry, geographical, economic and political factors. [326-30-35-9, 55-2]

The information to consider includes but is not limited to all of the following: [326-30-55-2, 55-4]

- the remaining payment terms of the security;
- prepayment speeds;
- the financial condition of the issuer;
- expected defaults;
- the value of any underlying collateral; and
- how credit enhancement affects the performance of the security, if the credit enhancement is not a separate contract (see section 9.2 for additional guidance to determine if the credit enhancement is freestanding).

When evaluating the issuer's financial condition, we believe an entity should evaluate whether financing will be necessary for the issuer to make the contractual payments and whether the issuer will be able to obtain such financing.

## **Question 19.4.10** How does an entity determine a best estimate of credit losses when measuring expected credit losses?

**Interpretive response:** When measuring expected credit losses, we believe an entity should determine the best estimate of credit losses by selecting one of the following two approaches and applying it consistently.

- **Single most-likely approach**, which is the single most-likely amount in a range of possible estimated amounts. This approach is based on the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

definition of best estimate in FASB Concepts Statement 7 (CON 7). See Example 19.4.02.

- **Probability-weighted approach**, which is the sum of the probability-weighted amounts in a range of possible estimated amounts. This approach is based on the expected cash flow method in CON 7. See Example 19.4.05.

## Example 19.4.02 Single most-likely cash flow approach

Assuming the following probabilities, an entity uses the following information to determine the estimate of expected credit losses. For simplicity, this example ignores the impact of discounting.

| Likelihood of scenario | Credit loss ($)[1] |
|---|---|
| 40% | 25 |
| 30% | 15 |
| 20% | 10 |
| 10% | 5 |

Note:
1. The difference between the contractual cash flows and cash flows expected to be collected (undiscounted).

Because a $25 credit loss has the highest probability of occurring, it is the estimate of expected credit losses.

## Example 19.4.05 Probability-weighted cash flow approach

Under a probability-weighted cash flow approach, an entity used the following information to determine the estimate of expected credit losses. For simplicity, this example ignores the impact of discounting.

| Likelihood of scenario | Credit loss ($)[1] | Probability-weighted credit losses ($) |
|---|---|---|
| 40% | 25 | 10.00 |
| 30% | 15 | 4.50 |
| 20% | 10 | 2.00 |
| 10% | 5 | 0.50 |
| Total | | 17.00 |

Note:
1. The difference between the contractual cash flows and cash flows expected to be collected (undiscounted).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Based on a probability-weighted approach, $17.00 is the estimate of expected credit losses.

## **Question 19.4.15** What considerations are relevant in selecting a discount rate used to determine the present value of expected cash flows?

**Interpretive response:** Some considerations related to calculating the EIR include the following.

- **Expected prepayments.** To determine the EIR used to discount expected cash flows, an entity is permitted to make an accounting policy election to consider timing (and changes in timing) of expected cash flows resulting from expected prepayments. This policy election should be applied consistently for debt securities at the major security type level. [326-30-35-7A]
- **Variable (floating) rate securities.** To determine the EIR of a variable rate security, an entity is permitted to use either the floating rate as it changes over the life of the security, or a fixed rate equal to the rate that was in effect at the date the entity determined that a credit loss existed. Further, an entity may be permitted to elect to project future interest rates. These elections are discussed in section 19.4.20.

The EIR used to discount expected cash flows when estimating credit losses is not necessarily the EIR used for interest income recognition. For further discussion of the EIR, see section 4.4.

When the most-likely approach is used to estimate cash flows, the discount rate is the AFS debt security's EIR as described above. If the probability-weighted approach is used, the discount rate should also considers the AFS debt security's EIR as described above, but excludes those adjustments already considered in the probability weightings. The resulting discount rate would be expected to be less than the AFS debt security's EIR and greater than the risk-free rate at the security's acquisition date.

## **Question 19.4.20** Does a decrease in expected cash flows solely due to an increase in expected prepayments result in a credit loss?

**Interpretive response:** No, we do not believe a decrease in expected cash flows resulting solely from an increase in expected prepayments can result in a credit loss for an AFS debt security that is not a beneficial interest in the scope of Subtopic 325-40; for additional discussion of the scope of Subtopic 325-40, see chapter 20. For example, this could occur with a prepayable asset-backed security purchased at a premium if prepayments result in a reduction in interest collected over the life of the security when compared with the cash flows originally expected at the purchase date.

We do not believe increases in prepayment expectations are an indicator of credit impairment based on the factors outlined in paragraphs 326-30-55-1 to

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

55-4. Under legacy US GAAP (superseded paragraph 320-10-35-33E), a decrease in cash flows expected to be collected caused by a change in prepayment speeds did not cause an OTTI for AFS debt securities other than beneficial interests. We believe that the FASB did not intend to change current practice in this area.

Further, as discussed in Question 19.4.15, an entity is permitted to make an accounting policy election to apply a prepayment-adjusted EIR when discounting expected cash flows. This election would have the effect of eliminating differences between the present value of the expected cash flows and the amortized cost due to changes in prepayment expectations. [326-30-35-7A]

We believe that if an entity instead chooses to use the original EIR when estimating a credit loss, a decrease in cash flows expected to be collected on a non-beneficial interest AFS debt security that results solely from an increase in prepayments will not result in a credit loss.

For a discussion on the effect of prepayments on credit loss estimates for investments in beneficial interests, see chapter 20.

## **Example 19.4.10** Impairment of AFS securities

ABC Corp. holds non-prepayable AFS debt securities that bear the same CUSIP number.

At the end of Year 1, the debt securities have the following characteristics.

| | |
|---|---|
| Fair value | 875,000 |
| Par value | 1,000,000 |
| Amortized cost basis | 952,000 |
| Coupon | 5% |
| EIR at acquisition date | 6.8% |
| Maturity date | End of Year 4 |
| Principal due | Only on maturity |

ABC does not intend to sell the debt securities, and it is not more likely than not that it will be required to sell the securities before recovering the amortized cost basis.

***Scenario 1: Recording impairment related to credit and non-credit losses***

At the end of Year 1, the securities are impaired because their fair value is less than their amortized cost basis. ABC considers the guidance in paragraph 326-30-35-6 and paragraphs 326-30-55-1 to 55-4 to determine if a credit loss exists. After considering information about past events, current conditions, and reasonable and supportable forecasts, ABC develops the following estimate of future expected cash flows.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Expected cash flows | Present value of future expected cash flows |
|---|---|---|
| 2 | 45,000 | 42,127 |
| 3 | 45,000 | 39,437 |
| 4 | 975,000 | 799,912 |
| | | 881,476 |

Because the present value of cash flows expected to be collected ($881,476) is less than the amortized cost basis of the securities ($952,000), ABC determines that a credit loss exists and records the following journal entries.

| | Debit | Credit |
|---|---|---|
| Credit loss expense[1] | 70,524 | |
| Allowance for credit losses | | 70,524 |
| *To record impairment related to credit losses.* | | |
| Unrealized loss on AFS debt securities (other comprehensive income)[2] | 6,476 | |
| AFS debt securities – fair value adjustment | | 6,476 |
| *To record non-credit related losses.* | | |

Notes:

1. The difference between the amortized cost basis ($952,000) and the present value of cash flows expected to be collected ($881,476).
2. The difference between the present value of cash flows expected to be collected ($881,476) and the fair value of the AFS debt securities ($875,000).

### *Scenario 2: Impairment limited by fair value floor*

Assume the same fact pattern as in Scenario 1, except that the fair value of the AFS debt securities only declined to $895,000 rather than $875,000.

In this scenario, ABC records the following journal entry because the allowance for credit losses is limited to the amount that the fair value is less than the amortized cost basis.

| | Debit | Credit |
|---|---|---|
| Credit loss expense[1] | 57,000 | |
| Allowance for credit losses | | 57,000 |
| *To record impairment related to credit losses.* | | |

Note:

1. The difference between the amortized cost basis ($952,000) and the fair value of the AFS debt securities ($895,000).

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 19.4.25** How are credit losses for a forward contract to purchase AFS debt securities accounted for?

**Interpretive response:** Expected credit losses for the underlying securities are recognized at the date the forward contract is entered into to purchase the AFS debt securities. further We believe the estimate of credit losses on the underlying securities should be calculated using the amortized cost basis of the debt securities expected to be recognized at settlement of the forward (i.e. forward exercise price plus cost of the forward, if applicable). We believe an entity recognizes the allowance as follows. [815-10-35-5(b)]

- For non-PCD AFS debt securities, an allowance for credit losses is recognized with an offset to credit loss expense.
- For PCD AFS debt securities, an allowance for credit losses is recognized with a balance sheet gross up to the initial cost basis of the forward contract.

We believe the allowance is limited by the amount that the underlying security's amortized cost basis exceeds fair value. As a result, an entity will need to track the amortized cost and fair values of the underlying AFS debt securities.

## **Example 19.4.15** Forward contract to purchase PCD AFS debt securities

On January 1, Year 1 (contract inception), ABC Corp. enters into a forward contract to acquire a portfolio of debt securities. The exercise price of the forward contract is $750,000. The transaction settles on March 31, Year 1 (settlement date). No amounts were paid or received to enter into the forward contract and the contract has a fair value of $0 on inception and settlement date.

The forward is in the scope of Topic 320 because it is not accounted for as a derivative under Topic 815 and the securities (once acquired) will be in the scope of Topic 320. ABC will classify the debt securities as AFS upon acquisition. Therefore, the forward contract is designated as AFS at inception.

ABC evaluates the individual debt securities in the portfolio to be purchased against the indicators in Subtopic 326-30 to determine which securities, if any, are considered PCD (see section 19.8.20)

The debt securities with the following characteristics are considered PCD.

| | |
|---|---|
| Par value: | 1,000,000 |
| Fair value (at inception and settlement of forward): | 750,000 |

ABC estimates the allowance for credit losses to be $143,130. The non-credit discount of $106,870 is the difference between the par value of $1,000,000 and the amortized cost basis of $893,130 ($750,000 purchase price plus the allowance for credit losses of $143,130). There is no change in the allowance estimate between contract inception and settlement.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The allowance for credit losses is not limited by the fair value floor because the amortized cost basis of the underlying securities ($893,130) exceeds the fair value ($750,000) by $143,130.

ABC records the following journal entries at inception of the forward (January 1, Year 1).

| | Debit | Credit |
|---|---|---|
| Forward contract – AFS debt securities | 143,130 | |
| Allowance for credit losses | | 143,130 |
| *To record the allowance for credit losses on Jan 1.* | | |

ABC records the following journal entries at settlement (March 31, Year 1).

| | Debit | Credit |
|---|---|---|
| AFS debt securities[1] | 1,000,000 | |
| Cash | | 750,000 |
| AFS debt securities – non-credit discount | | 106,870 |
| Forward contract – AFS debt securities | | 143,130 |
| *To recognize debt securities and payment of cash on the settlement date (Dec 31).* | | |

Note:

1. At settlement, no journal entry is made to the allowance for credit losses because the allowance for credit losses related to the AFS debt securities was recognized during the period that the forward contract was outstanding.

## 19.4.20 Specific considerations for variable rate securities

### Excerpt from ASC 326-30

• • > Impairment in Earnings and Other Comprehensive Income

**35-11** If the security's contractual interest rate varies based on subsequent changes in an independent factor, such as an index or rate, for example, the prime rate, the London Interbank Offered Rate (LIBOR), or the U.S. Treasury bill weekly average, that security's effective interest rate (used to discount expected cash flows as described in paragraph 326-30-35-7) may be calculated based on the factor as it changes over the life of the security or is projected to change over the life of the security, or may be fixed at the rate in effect at the date an entity determines that the security has a credit loss as determined in accordance with paragraphs 326-30-35-1 through 35-2. The entity's choice shall be applied consistently for all securities whose contractual interest rate varies based on subsequent changes in an independent factor. An entity is not required to project changes in the factor for purposes of estimating expected future cash flows. If the entity projects changes in the factor for the purposes

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

of estimating expected future cash flows, it shall use the same projections in determining the effective interest rate used to discount those cash flows. In addition, if the entity projects changes in the factor for the purposes of estimating expected future cash flows, it shall adjust the effective interest rate used to discount expected cash flows to consider the timing (and changes in timing) of expected cash flows resulting from expected prepayments in accordance with paragraph 326-30-35-7A. Subtopic 310-20 on receivables—nonrefundable fees and other costs provides guidance on the calculation of interest income for variable rate instruments.

Entities often hold variable rate AFS debt securities. A variable rate can add complexity to the determination of the EIR for these types of securities. However, Subtopic 326-30 simplifies the calculation by permitting an entity to use one of the following rates when a security's contractual interest rate varies based on an independent factor: [326-30-35-11]

- the floating rate as it changes over the life of the security; or
- a fixed rate equal to the rate that was in effect at the date the entity determined that a credit loss existed.

Selecting one of these rates amounts to a policy election that requires use of that rate on all AFS securities whose interest rate is based on an independent factor. [326-30-35-11]

Further, an entity is permitted to use its projections of future interest rates when estimating expected future cash flows on variable rate financial assets. If the entity makes such projections, the same projections are also used in determining the EIR for discounting those cash flows. Under this alternative, the entity also adjusts the EIR for expected prepayments (see Questions 19.4.10 and 19.4.20). [326-30-35-11]

## **Question 19.4.30** What does an entity consider when determining the EIR for a variable rate debt security?

**Interpretive response:** The alternatives provided by Subtopic 326-30 may either create or eliminate volatility in the estimation of a credit loss, depending on the extent to which the cash flows expected to be collected include interest payments that will adjust based on changes in a floating interest rate index.

Therefore, when making an accounting policy election related to the EIR used to determine the present value of the expected cash flows, an entity should consider the potential effect on the estimation of credit losses in future periods.

The option to fix the rate at the date the entity determined that a credit loss existed is only available for AFS securities and is not available for HTM securities.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 19.4.30 Accrued interest receivable

### Excerpt from ASC 326-30

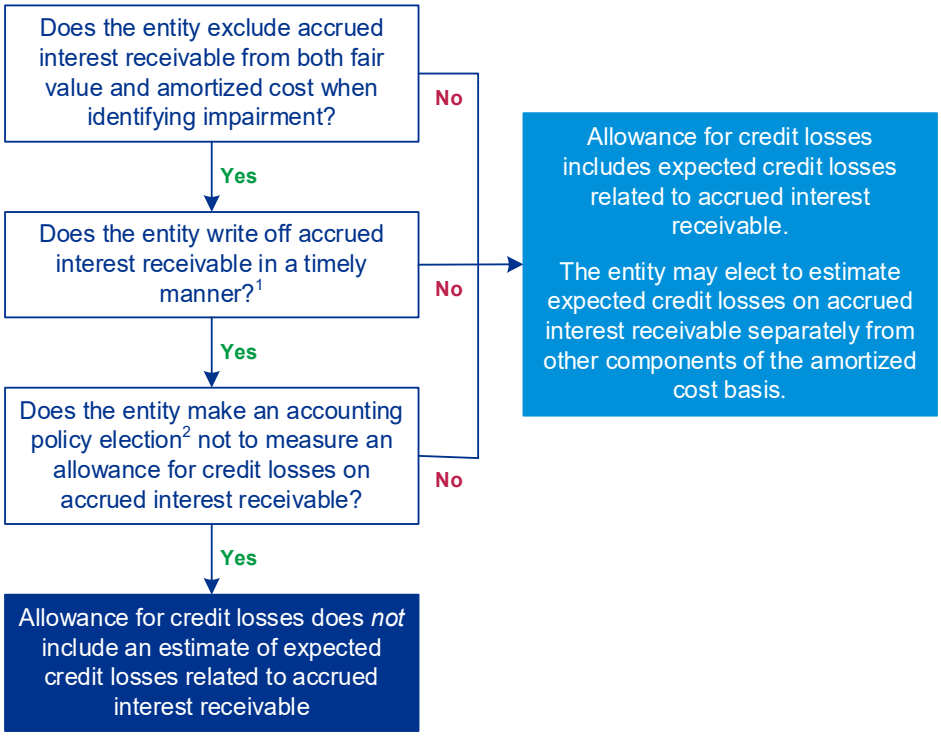
**30-1A** If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the **fair value** and the **amortized cost basis** of the available-for-sale debt security, an entity may develop its estimate of expected credit losses by measuring components of the amortized cost basis on a combined basis or by separately measuring the applicable accrued interest component from the other components of amortized cost basis.

**30-1B** If an entity excludes applicable accrued interest from both the fair value and the amortized cost basis of the available-for-sale debt security, the entity may make an accounting policy election, at the major security-type level, not to measure an allowance for credit losses for accrued interest receivables if it writes off the uncollectible accrued interest receivable balance in a timely manner. An entity that elects the accounting policy in this paragraph shall meet the disclosure requirements in paragraph 326-30-50-3C. This accounting policy election shall be considered separately from the accounting policy election in paragraph 326-30-35-13A. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.

A debt security's amortized cost includes the related accrued interest receivable. In response to stakeholder concerns, the FASB provided relief from identifying and measuring impairment on accrued interest receivable in certain situations.

If an entity determines that a credit loss exists, as discussed in section 19.3.20, it estimates an allowance for credit losses. The following decision tree summarizes whether an entity's allowance for credit losses should include an estimate of credit losses related to accrued interest receivable balances for AFS debt securities with a credit loss. [326-30-30-1A – 30-1B]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.




Notes:

1. As discussed in Question 4.2.40, the FASB decided not to provide a specific time period that is considered 'timely'.
2. The accounting policy election is made at the major security-type level.

In addition to the relief summarized in the decision tree, the FASB provided relief related to how an entity may write off accrued interest receivable (see Question 19.6.30) and relief from certain presentation and disclosure requirements (see Question 23.2.05 and section 24.3.60, respectively).

## 19.5 Accounting for a credit loss

### 19.5.10 Overview

**Excerpt from ASC 326-30**

• > Identifying and Accounting for Impairment

**35-2** For individual **debt securities** classified as **available-for-sale securities**, an entity shall determine whether a decline in fair value below the amortized cost basis has resulted from a credit loss or other factors. An entity shall record impairment relating to credit losses through an allowance for credit losses. However, the allowance shall be limited by the amount that the fair value is less than the amortized cost basis. Impairment that has not been recorded through an allowance for credit losses shall be recorded through other comprehensive income, net of applicable taxes. An entity shall consider the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

guidance in paragraphs 326-30-35-6 and 326-30-55-1 through 55-4 when determining whether a credit loss exists.

**35-3** At each reporting date, an entity shall record an allowance for credit losses that reflects the amount of the impairment related to credit losses, limited by the amount that fair value is less than the amortized cost basis. Changes in the allowance shall be recorded in the period of the change as credit loss expense (or reversal of credit loss expense).

Once a credit loss is estimated for an impaired AFS debt security, it is recognized through an allowance rather than as a direct writeoff of the security's amortized cost basis, unless the amount is deemed uncollectible (see Question 19.6.20). [326-30-35-2]

There is an exception for AFS securities that meet one of the following conditions:

- the entity intends to sell the security; or
- it is more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis.

The treatment of an impairment of an AFS debt security that meets one of these conditions is discussed in section 19.5.20.

When a credit loss is recognized through an allowance, the amount of the allowance is limited by the amount that the security's amortized cost basis exceeds the security's fair value – called the 'fair value floor'. [326-30-35-2]

## 19.5.20 Credit losses when an entity intends to sell, or more likely than not will be required to sell, a debt security

### Excerpt from ASC 326-30

• • > Impairment in Earnings and Other Comprehensive Income

**35-10** If an entity intends to sell the debt security (that is, it has decided to sell the security), or more likely than not will be required to sell the security before recovery of its amortized cost basis, any allowance for credit losses shall be written off and the amortized cost basis shall be written down to the debt security's fair value at the reporting date with any incremental impairment reported in earnings. If an entity does not intend to sell the debt security, the entity shall consider available evidence to assess whether it more likely than not will be required to sell the security before the recovery of its amortized cost basis (for example, whether its cash or working capital requirements or contractual or regulatory obligations indicate that the security will be required to be sold before the forecasted recovery occurs). In assessing whether the entity more likely than not will be required to sell the security before recovery of its amortized cost basis, the entity shall consider the factors in paragraphs 326-30-55-1 through 55-2.

When an entity intends to sell a debt security, or more likely than not will be required to sell a debt security before recovery of its amortized cost basis, it

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

recognizes the difference between the fair value and amortized cost in net income and as a writedown of the amortized cost of the AFS security. Therefore, when a debt security is impaired, an entity must make assertions about its intent to sell the security or whether it is more likely than not that it will be required to sell the security before the recovering the security's amortized cost. [326-30-35-10]

## **Question 19.5.10** How does an entity determine whether it has an intent to sell a debt security?

**Interpretive response:** The intent to sell a debt security means that the entity has decided as of the reporting date to sell the security. If the entity has decided to sell the debt security and the decision is not contingent on the occurrence of a future event, then the entity has the intent to sell the security. If the entity has decided to sell the debt security and the sale is contingent on the occurrence of an event, see Question 19.5.20.

Topic 326 does not provide guidance on what policies an entity should have for identifying debt securities that it has decided to sell. However, the following are examples of indicators suggesting it is likely that management has decided to sell:

- management (or its portfolio manager) with the proper authority has approved the sale of the security;
- the security is marketed to be sold at a price that approximates current fair value.

Policies for identifying AFS debt securities an entity intends to sell may vary among entities. For example, an entity may choose to identify securities on a security-by-security basis or identify groups of securities. The objective of the policies is for an entity to follow a process for making decisions about securities to be sold, identifying those securities, and documenting both its decision to sell specific debt securities selected and when the decision was made. See Question 19.5.40 for additional guidance when an entity uses a portfolio manager.

## **Question 19.5.20** How does an entity determine whether it has an intent to sell if it has decided to sell a debt security only upon the occurrence of a contingent event?

**Background:** An entity has made the decision to sell a debt security as discussed in Question 19.5.10; however, the sale will take place only if a specified event occurs. For example, management with the proper authority has approved the sale of the security if the fair value of the security increases above a specified amount.

**Interpretive response:** We believe an entity should evaluate whether it is probable that the contingent event will occur prior to the debt security's

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

maturity date. If an entity concludes it is probable as of the reporting date that the contingent event will occur prior to the debt security's maturity date, we believe the entity would have the present intent to sell as of the reporting date. In contrast, if the entity, as of the reporting date, concludes that it is not probable that the contingent event will occur prior to the debt security's maturity date, we believe it would not have the present intent to sell as of the reporting date.

## **Question 19.5.30** If a decision to sell has not yet been made, does an entity need to assess the likelihood that it may sell a debt security?

**Interpretive response:** No. If a decision to sell has not been made, we do not believe an entity needs to consider the likelihood that it may sell a debt security. For example, an entity would not need to assess whether an 80% likelihood of selling a security indicates an intent to sell the security. The intention to sell a debt security means that the entity has decided to sell the security as of the reporting date. This situation differs from that in Question 19.5.20, which addresses when the decision to sell upon occurrence of a contingent event has been made. [326-30-35-10]

## **Question 19.5.40** Does use of a portfolio manager impact how an entity determines if it has an intent to sell a debt security?

**Background:** In certain circumstances an entity will give a portfolio manager discretion over investment decisions for a portfolio of debt securities. The portfolio management function may be internal or outsourced. The decision making authority regarding whether to sell a given debt security may reside solely with the portfolio manager (including situations in which the security is impaired.)

**Interpretive response:** Yes. An entity should consider which party has the authority to decide whether to sell a security. This includes understanding of the terms of the contract/relationship with the portfolio manager and determining the portfolio manager's authority to sell securities.

| Arrangement | Impact |
|---|---|
| **The contract (or relationship, if internal) includes a provision restricting the portfolio manager's ability to sell securities in the portfolio.** | Entity, not the portfolio manager, determines whether to sell a debt security. Therefore, the intent to sell assessment and related documentation supporting the respective assertions focuses on the entity. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Arrangement | Impact |
|---|---|
| **The contract (or relationship, if internal) does not include a provision restricting the portfolio's manager's ability to sell securities in the portfolio.** | The entity should consider whether the portfolio manager has the ability to sell the security without the entity's input.<br>Documentation supporting the intent to sell assessment should consider (1) the portfolio manager relationship and its effect on the entity's assertion and (2) any contractual obligations with other parties that would affect the portfolio manager's actions.<br>The entity should obtain, as part of its assessment and related documentation, (1) information from the portfolio manager supporting whether the portfolio manager intends to sell the debt security as of the reporting date and (2) an understanding of how the portfolio manager supports its conclusions. The intent to sell assessments and related documentation supporting the respective assertions should focus on both the entity and the portfolio manager. |

## **Question 19.5.50** How does an entity determine whether it will more likely than not be required to sell a debt security?

**Interpretive response:** An entity should consider all available evidence when assessing whether:

- it will be required to sell a security before recovery of its amortized cost basis; and
- the likelihood of such event.

This includes evaluating whether its cash or working capital requirements, contractual or regulatory obligations and liquidity needs indicate that the security will be required to be sold before the forecasted recovery occurs. In additional to the above, an entity considers the factors in paragraphs 326-30-55-1 to 55-2 when making this assessment (see Questions 19.3.20 and 19.4.05). [326-30-35-10]

The requirement to sell assertion is generally only used when an entity is or will be required to sell a debt security in response to:

- external compulsion (e.g. contractual or regulatory); or
- working capital requirements or cash needs after it has exhausted all other sources of cash or working capital, such as when an entity is unable to raise additional debt, securitize assets or draw from credit lines.

In other circumstances, an entity would evaluate whether it has the intent to sell.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 19.5.60** What are the documentation considerations related to the intent or requirement to sell assertions?

**Interpretive response:** When a debt security is impaired, an entity must make assertions about its intent to sell or whether it is more likely than not that it will be required to sell the security before the recovery of its amortized cost basis.

The assessment should be documented on a timely basis to support the assertions. This would allow for a review of the facts and circumstances that led to the original decisions if the entity changes its assertions after the reporting date (e.g. sales occur after the reporting date for securities not intended to be sold). We believe documentation should include the authorized personnel making the decision to sell, as well as the reasons and timing for the decision or requirement to sell.

## **Question 19.5.70** What does an entity consider if it sells a security at a loss shortly after the reporting date but had not previously asserted an intent to sell the security?

**Background:** A credit loss is recognized in the period in which a decision to sell has been made and not the period in which the sale occurs (unless the decision and the sale occurred in the same period). An entity may have asserted, as of the reporting date, that it had not made a decision to sell an impaired security, and therefore did not recognize a credit loss. However, the security may be sold at a loss shortly after the reporting date.

**Interpretive response:** Subsequent sales shortly after period-end may call into question the appropriateness of the timing in which the write off of any previously recognized allowance and direct write down of the security occurred. In this instance, we believe an entity should be able to demonstrate that the sale decision was made due to a change in intent that resulted from a change in facts and circumstances, such as changes in market conditions, the entity's economic condition or the regulatory environment. Sufficient contemporaneous documentation, as described in Question 19.5.60, at the reporting date and when the entity's assertion changed can support the timing of the accounting for the impairment.

The shorter the time period between an entity 's assertion that it does not intend to sell and a subsequent sale, the more important it is for an entity to re-evaluate previous and future assertions. Similarly, the larger the number of such sales the more important this evaluation becomes. Likewise, if an entity identifies securities that it intends to sell but does not sell them within a time period consistent with the assessment supporting the assertion, the entity should evaluate the change in facts and circumstances after the reporting date to determine if its intent to sell assertion continues to be appropriate.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Example 19.5.10** Accounting for impairment when it is more likely than not that an entity will be required to sell the security before recovery

Assuming the same fact pattern and future cash flows as in Example 19.4.10 Scenario 1, ABC Corp. determines at the beginning of Year 2 that it is more likely than not that it will be required to sell the securities before recovery of the amortized cost basis.

As a result, the previously recognized allowance for credit losses is written off and the amortized cost basis is written down to the debt securities' fair value with any incremental impairment reported in net income.

ABC records the following journal entries related to the debt securities.

| | Debit | Credit |
|---|---|---|
| Allowance for credit losses | 70,524 | |
| AFS debt securities – fair value adjustment | 6,476 | |
| AFS debt securities – amortized cost | | 77,000 |
| *To write off allowance for credit losses, reverse fair value adjustment, and adjust amortized cost basis.* | | |
| Impairment loss | 6,476 | |
| Unrealized loss on AFS debt securities (other comprehensive income) | | 6,476 |
| *To record additional impairment loss in net income.* | | |

## 19.6 Accounting for a debt security subsequent to credit impairment

### 19.6.10 Overview

**Excerpt from ASC 326-30**

> Accounting for Debt Securities after a Credit Impairment

**35-12** An entity shall reassess the credit losses each reporting period when there is an allowance for credit losses. An entity shall record subsequent changes in the allowance for credit losses on available-for-sale debt securities with a corresponding adjustment recorded in the credit loss expense on **available-for-sale debt securities**. An entity shall not reverse a previously recorded allowance for credit losses to an amount below zero.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**35-13** An entity shall recognize writeoffs of available-for-sale debt securities in accordance with paragraph 326-20-35-8.

**35-13A** If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the **fair value** and the **amortized cost basis** of the available-for-sale debt security, an entity may make an accounting policy election, at the major security-type level, to write off accrued interest receivables by reversing interest income or recognizing credit loss expense, or a combination of both. This accounting policy election shall be considered separately from the accounting policy election in paragraph 326-30-30-1A. An entity that elects this accounting policy shall meet the disclosure requirements in paragraph 326-30-50-3D. An entity may not analogize this guidance to components of amortized cost basis other than accrued interest.

AFS debt securities are evaluated for credit losses each reporting period using the guidance discussed in this chapter and the allowance for credit losses is adjusted accordingly. [326-30-35-12]

Reductions in the allowance for credit losses can be due to either (1) improvements in credit or (2) increases in the security's fair value that are independent of improvements in credit (i.e. changes to the fair value floor). Both types of reductions in the allowance are recorded through credit loss expense, and not in other comprehensive income. Unlike financial assets carried at amortized cost (including HTM debt securities), at no point should the allowance for credit losses be reduced below zero. [326-30-35-12, ASU 2019-04.BC43]

As previously discussed (see section 19.4.10), Subtopic 326-30 requires that credit losses be estimated using a discounted cash flow method. When applying this method, an entity can elect to report the change in the allowance for credit losses attributed to the passage of time as either interest income or credit loss expense (or benefit). This is a new election available under Subtopic 326-30 for AFS debt securities (see section 23.2). [326-30-45-3]

## **Question 19.6.10** Does an entity continue to accrue interest income for AFS debt securities with credit losses?

**Interpretive response:** It depends. Subtopic 326-30 does not address when a holder of an AFS debt security should place the debt security on nonaccrual status or how to subsequently report income on the nonaccrual debt security.

We believe an entity should apply the guidance in paragraph 310-10-35-53C for PCD assets to all AFS debt securities that are not beneficial interests when assessing when they should be placed on nonaccrual status. For further discussion of the application of nonaccrual status, see Question 19.8.20. We believe an entity should consistently apply its policies for placing AFS debt securities on nonaccrual status.

Additionally, the payment application method an entity uses for nonaccrual debt securities – cost recovery method, cash basis method or some combination of those methods – will affect the pattern in which payments reduce a security's amortized cost basis. Payment application methods that delay reductions in

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

amortized cost basis may lead to larger credit losses than methods that do not delay the reduction. [310-10-35-53A]

## **Question 19.6.20** Does an entity have to account for writeoffs under Subtopic 326-30?

**Interpretive response:** Yes. Subtopic 326-30 requires the recognition of writeoffs of AFS debt securities. [326-30-35-13]

Writeoffs of AFS debt securities are recorded in the period in which they are deemed uncollectible. Because of this new requirement, entities need to develop new processes, policies and controls for AFS debt securities. This includes policies addressing the timing of recognition for writeoffs. [326-30-35-13, 326-20-35-8]

Unlike financial assets measured at amortized cost, an entity is prohibited from recognizing a negative allowance for credit losses for AFS debt securities. [326-30-35-12]

## **Question 19.6.30** Must an entity write off accrued interest receivable as a deduction from the allowance for credit losses?

**Interpretive response:** No. In response to stakeholder concerns about changing the current nonaccrual practice of reversing accrued interest receivable through interest income, the FASB provided relief from the requirement to deduct writeoffs of accrued interest receivable from the allowance for credit losses.

The relief is available to an entity that excludes accrued interest receivable from both the fair value and amortized cost basis of debt securities for purposes of identifying and measuring impairment. Under the relief, an entity may make an accounting policy election to write off accrued interest receivable in any of the following ways; this election is made separately for each major security type: [326-20-35-13A]

- reversing interest income;
- recognizing credit loss expense; or
- a combination of both.

An entity's accounting policy election for writing off accrued interest receivable is made separately from its accounting policy election about whether its allowance for credit losses includes expected credit losses of accrued interest receivable (see section 19.4.30). See also Question 4.2.50, which includes a summary of how expected credit losses of accrued interest receivable may be reflected in an entity's income statement.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 19.6.10** Subsequent accounting for impairment of individual AFS securities

Assuming the same fact pattern as in Example 19.4.10, Scenario 1, ABC Corp. performs its assessment of credit losses related to its AFS debt securities at the end of Year 2. In doing so, ABC considers the factors in paragraph 326-30-35-6 and paragraphs 326-30-55-1 to 55-4 and develops the following estimate of future expected cash flows.

| Year | Expected cash flows | Present value of future expected cash flows |
|---|---|---|
| 3 | 60,000 | 56,169 |
| 4 | 1,000,000 | 876,378 |
| | | 932,547 |

Also assume that at the end of Year 2 the debt security has an amortized cost basis of $967,000 and a fair value of $910,000.

At the end of Year 2, the present value of cash flows expected to be collected is still less than the amortized cost basis of the security and ABC estimates that the credit loss is now $34,453 – i.e. amortized cost of $967,000 less present value of expected cash flows of $932,547. This credit loss is less than the previously recognized allowance for credit losses of $70,524. Therefore, the allowance for credit losses is reduced by $36,071.

ABC records the following journal entries related to the credit and non-credit losses that exist at the end of Year 2.

| | Debit | Credit |
|---|---|---|
| Allowance for credit losses | 36,071 | |
| Credit loss expense | | 36,071 |
| *To record recovery in credit losses.* | | |
| Unrealized loss on AFS debt securities (other comprehensive income) | 16,071 | |
| AFS debt securities – fair value adjustment | | 16,071 |
| *To record non-credit related losses.* | | |

ABC calculates the above entries as follows.

| | Year 1 | Year 2 | Difference |
|---|---|---|---|
| Allowance for credit losses | (70,524) | (34,453) | 36,071 |
| Unrealized loss (other comprehensive income)[1] | (6,476) | (22,547) | 16,071 |

Note:

1. The unrealized loss (other comprehensive income) at the end of Year 2 is the difference between the fair value of $910,000 and the amortized cost basis of $967,000, less the allowance for credit losses of $34,453.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 19.6.20 Accounting subsequent to a writedown to fair value

### Excerpt from ASC 326-30

> Accounting after a Write-Down Resulting from an Intent to Sell or a More-Likely-Than-Not Requirement to Sell

**35-14** Once an individual **debt security** has been written down in accordance with paragraph 326-30-35-10, the previous **amortized cost basis** less writeoffs, including non-credit-related impairment reported in earnings, shall become the new amortized cost basis of the investment. That new amortized cost basis shall not be adjusted for subsequent recoveries in **fair value**.

**35-15** For debt securities for which impairments were reported in earnings as a writeoff because of an intent to sell or a more-likely-than-not requirement to sell, the difference between the new amortized cost basis and the cash flows expected to be collected shall be accreted in accordance with existing applicable guidance as interest income. An entity shall continue to estimate the present value of cash flows expected to be collected over the life of the debt security. For debt securities accounted for in accordance with Subtopic 325-40, an entity should look to that Subtopic to account for changes in cash flows expected to be collected. For all other debt securities, if upon subsequent evaluation, there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, those changes shall be accounted for as a prospective adjustment to the yield. Subsequent increases in the fair value of available-for-sale securities after the write-down shall be included in other comprehensive income. (This Section does not address when a holder of a debt security would place a debt security on nonaccrual status or how to subsequently report income on a nonaccrual debt security.)

After recording impairment related to an AFS debt security because of an intent to sell or a more-likely-than-not requirement to sell before recovery of its amortized cost basis, the amortized cost basis of the debt security is reduced to the security's fair value (see section 19.5.20). [326-30-35-14]

The difference between the new amortized cost basis and the cash flows expected to be collected should be accreted as interest income over the life of the AFS debt security. To do this, an entity forecasts the cash flows associated with the AFS debt security each period until it is sold or paid in full. [326-30-35-15]

If there is a significant increase in the cash flows expected to be collected or if actual cash flows are significantly greater than cash flows previously expected, those increases are accounted for as a prospective adjustment to the yield on the AFS security. Beneficial interest debt securities accounted for in the scope of Subtopic 325-40 (see chapter 20) are not subject to this guidance. [326-30-35-15]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 19.6.40** How are decreases in expected cash flows from an AFS debt security accounted for when an entity no longer intends to sell the security?

**Background:** An entity should write down the amortized cost basis of an AFS debt security to fair value when it either (1) has an intent to sell the security or (2) it is more likely than not that it will be required to sell the security before recovery of the security's amortized cost basis. The fair value represents the new amortized cost basis of the debt security. An entity continues to recognize interest income for the difference between the cash flows expected to be collected over the life of the security and the amortized cost basis. [326-30-35-10, 35-15]

Subsequent to writing down the amortized cost basis of an AFS debt security to fair value, an entity may determine that it no longer has an intent to sell the security, or it is not more likely than not that it will be required to sell the security before recovery of the security's amortized cost basis. In these cases, specific guidance requires subsequent increases in expected cash flows to be accounted for as prospective adjustments to the security's yield. [326-30-35-15]

**Interpretive response:** We believe subsequent decreases in expected cash flows of an AFS debt security in this scenario should be accounted for as follows:

- recognize a decrease in the present value of expected cash flows through the allowance for credit losses, to the extent those changes in the present value of expected cash flows are not limited by the fair value floor; and [326-30-35-1 – 35-4, 35-6 – 35-7]
- consider whether the AFS debt security should be placed on nonaccrual status based on the entity's nonaccrual policy.

## 19.7 Comparison of accounting for debt securities as AFS and HTM

Because Topic 326 has different accounting models for AFS and HTM debt securities, the resulting credit losses for the same security could be different under each model. The following table summarizes the key differences that could result in different estimates of credit losses for debt securities.

| | AFS | | |
|---|---|---|---|
| | **Intent to sell or more likely than not required to sell** | **No intent to sell; not more likely than not required to sell** | **HTM** |
| **Unit of account** | Individual security/CUSIP. | Individual security/CUSIP. | Collective (pool) assessment when similar risk characteristics exist. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | AFS | | HTM |
|---|---|---|---|
| | **Intent to sell or more likely than not required to sell** | **No intent to sell; not more likely than not required to sell** | |
| **Is there a threshold for evaluating whether credit losses exist?** | No, when the security is impaired – i.e. fair value is less than amortized cost – that impairment is recognized in net income. | Yes, when the security is impaired – i.e. fair value is less than amortized cost – evaluate whether the decline is a result of a credit loss or due to other factors. | No threshold for evaluation. All securities are evaluated for recognition of a lifetime loss allowance. |
| **Can a qualitative assessment be made to determine if credit losses exist?** | Not applicable, because the entire impairment is recognized in net income. | It depends. If an assessment of the qualitative factors results in the expectation that all contractual cash flows will be received, a quantitative assessment is not required. Otherwise, a quantitative assessment should be performed. | No, the expected credit loss model requires a quantitative assessment of the expected credit losses at each reporting date. |
| **Credit loss estimate** | No separate estimate required. The entire difference between the fair value and amortized cost is written off. | Difference between present value of expected cash flows and the amortized cost basis, limited by the difference between fair value and amortized cost (i.e. fair value floor).<br>At no point should the allowance be reduced below zero. | Credit loss expected to be incurred over the life of the financial asset, not constrained by the fair value of the financial asset.<br>The allowance may be reduced below zero for expected recoveries. |
| **Method to estimate credit losses** | Not applicable, because the entire difference between the fair value and amortized cost is written off. | Discounted cash flow method. | Various methods may be appropriate as included in Subtopic 326-20. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 19.8 Purchased AFS securities with credit deterioration

## Excerpt from ASC 326-30

> Purchased financial assets with credit deterioration

**30-2** A purchased **debt security** classified as available-for-sale shall be considered to be a **purchased financial asset with credit deterioration** when the indicators of a credit loss in paragraph 326-30-55-1 have been met. The allowance for credit losses for purchased **financial assets** with credit deterioration shall be measured at the individual security level in accordance with paragraphs 326-30-35-3 through 35-10. The **amortized cost basis** for purchased financial assets with credit deterioration shall be considered to be the purchase price plus any allowance for credit losses. See paragraphs 326-30-55-1 through 55-7 for implementation guidance.

**30-3** Estimated credit losses shall be discounted at the rate that equates the present value of the purchaser's estimate of the security's future cash flows with the purchase price of the asset.

**30-4** An entity shall record the **holding gain or loss** through other comprehensive income, net of applicable taxes.

## 19.8.10 Overview

Special accounting provisions apply to PCD AFS securities.

When an entity acquires a PCD AFS debt security, it applies the 'gross up' method. Under this method, the Day 1 allowance for credit losses is added to the purchase price to determine the initial amortized cost basis. Therefore, there is no credit loss expense affecting net income on acquisition. [326-30-30-2]

## 19.8.20 Identifying purchased AFS securities with credit deterioration

Whether AFS securities should be considered PCD is determined at the individual security level.

PCD accounting applies to a purchased AFS security that experienced a credit loss. To determine if a security has experienced a credit loss, an entity considers the following indicators: [326-30-30-2, 55-1]

- the extent to which the fair value is less than the par value of the security – this comparison is likely not relevant for zero coupon bonds;
- adverse conditions specifically related to the security, an industry or geographic area;
- the payment structure of the debt security and the likelihood of the issuer being unable to make payments that increase in the future;

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- failure of the issuer of the security to make scheduled interest or principal payments; and
- any changes to the rating of the security by a rating agency.

## **Question 19.8.10** Are there different concepts for assessing whether AFS and HTM debt securities qualify for PCD accounting?

**Interpretive response:** Yes, an entity applies different concepts to determine when to use PCD accounting for an AFS and an HTM debt security.

### *HTM debt securities*

For an HTM debt security, PCD accounting applies when, at the date of acquisition, the security has experienced a more-than-insignificant deterioration in credit quality since its initial issuance. [326-20 Glossary]

The FASB stated that it did not intend for PCD accounting to be limited to financial assets that were considered nonaccrual or impaired under legacy US GAAP. Instead, the FASB intended it to also apply to assets that had experienced a more-than-insignificant level of credit deterioration since origination. For a more detailed discussion, see chapter 12. [ASU 2016-13.BC90]

### *AFS securities*

In contrast, as explained in Question 19.8.20, PCD accounting applies to a purchased AFS security when indicators of a credit loss exist at the time of acquisition. [326-30-30-2]

## Excerpt from ASC 326-30

• > Example 1: Identifying Purchased Financial Assets with Credit Deterioration

**55-5** This Example illustrates one way an entity may identify purchased financial assets with credit deterioration.

**55-6** Entity A purchases a portfolio of debt securities with varying levels of credit quality that it classifies as available for sale. When determining which individual available-for-sale debt securities should be considered to be in the scope of the guidance for purchased financial assets with credit deterioration, Entity A considers the indicators of impairment in paragraph 326-30-55-1. Entity A also considers its practices for identifying credit losses on available-for-sale debt securities. If Entity A determines that, on an individual basis, the purchased debt securities are purchased financial assets with credit deterioration, it should classify them as such.

**55-7** Entity A also considers the securities that are within the scope of Subtopic 325-40 on beneficial interests in securitized financial assets. Entity A purchases a residual tranche and determines that there is a significant difference between contractual cash flows and expected cash flows. In

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

accordance with paragraph 325-40-30-1A(a), Entity A applies the accounting for purchased financial assets with credit deterioration to the residual tranche.

## 19.8.30 Initially measuring purchased AFS securities with credit deterioration

When recognizing interest income on PCD financial assets, it is not appropriate to accrete from the purchase price to the contractual cash flows. [ASU 2016-13.BC85]

Under Subtopic 326-30, the discount embedded in the purchase price attributable to a credit loss at the date of acquisition of a PCD AFS security is not recognized as interest income, but rather is recorded as an allowance for credit losses. [326-30-30-2]

### **Example 19.8.10** PCD AFS debt securities – initial measurement

ABC Corp. acquires a portfolio of debt securities that have varying levels of credit quality and classifies them as AFS.

ABC evaluates the individual debt securities in the portfolio against the criteria in Subtopic 326-30 to determine which securities, if any, should be considered PCD. ABC does not pay or receive any fees or incur any transaction costs, associated with this acquisition.

ABC considers the criteria in paragraphs 326-30-30-2 and 55-1 and determines that debt securities with the following characteristics should be considered PCD.

| | |
|---|---|
| Par value: | 1,000,000 |
| Purchase price: | 750,000 |
| Contractual term (acquired at the end of Year 1): | Five years |
| Coupon: | 5% |
| Principal due: | Only at maturity |

After considering information about past events, current conditions, and reasonable and supportable forecasts, ABC determines the following initial cash flow expectations related to the PCD debt securities.

| Year | Contractual cash flows | Expected cash flows | Credit losses | Present value of credit losses |
|---|---|---|---|---|
| 2 | 50,000 | 40,000 | 10,000 | 9,238 |
| 3 | 50,000 | 35,000 | 15,000 | 12,802 |
| 4 | 50,000 | 35,000 | 15,000 | 11,827 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Contractual cash flows | Expected cash flows | Credit losses | Present value of credit losses |
|---|---|---|---|---|
| 5 | 1,050,000 | 900,000 | 150,000 | 109,263 |
| Total | | | | 143,130 |

Under the guidance in paragraph 326-30-30-3, ABC determines the EIR to be 8.24% (rounded). This is the rate that equates the present value of the security's estimated future cash flows with the purchase price of $750,000.

ABC estimates the allowance for credit losses to be $143,130 and the amortized cost basis of the debt securities to be $893,130 – i.e. $750,000 purchase price plus the allowance for credit losses of $143,130.

ABC records the following journal entry at acquisition.

| | Debit | Credit |
|---|---|---|
| AFS debt securities | 1,000,000 | |
| Allowance for credit losses | | 143,130 |
| AFS debt securities – non-credit discount | | 106,870 |
| Cash | | 750,000 |
| *To record acquisition of PCD AFS debt securities, and estimates of credit losses and non-credit discount.* | | |

## 19.8.40 Subsequently measuring purchased AFS securities with credit deterioration

### Excerpt from ASC 326-30

• > Purchased Financial Assets with Credit Deterioration

**35-16** An entity shall measure changes in the allowance for credit losses on a **purchased financial asset with credit deterioration** in accordance with paragraph 326-30-35-6. The entity shall report changes in the allowance for credit losses in net income as credit loss expense (or reversal of credit loss expense) in each reporting period.

**35-17** This Subtopic does not address how an entity shall recognize interest income. See paragraphs 310-10-35-53A through 35-53C for guidance on recognition of interest income on purchased financial assets with credit deterioration.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Excerpt from ASC 310-10

• > Interest Income

**35-53A** Except as noted in paragraphs 310-10-35-53B through 35-53C, this Subsection does not address how a creditor should recognize, measure, or display interest income on a financial asset with a credit loss. Some accounting methods for recognizing income may result in an amortized cost basis of a financial asset that is less than the amount expected to be collected (or, alternatively, the fair value of the collateral). Those accounting methods include recognition of interest income using a cost-recovery method, a cash-basis method, or some combination of those methods.

**35-53B** When recognizing interest income on **purchased financial assets with credit deterioration** within the scope of Topic 326, an entity shall not recognize as interest income the discount embedded in the purchase price that is attributable to the acquirer's assessment of expected credit losses at the date of acquisition. The entity shall accrete or amortize as interest income the non-credit-related discount or premium of a purchased financial asset with credit deterioration in accordance with existing applicable guidance in Section 310-20-35 or 325-40-35.

**35-53C** Recognition of income on purchased financial assets with credit deterioration is dependent on having a reasonable expectation about the amount expected to be collected. Subsequent to purchase, this Subtopic does not prohibit placing financial assets on nonaccrual status, including use of the cost recovery method or cash basis method of income recognition, when appropriate. For example, if the timing of either a sale of the financial asset into the secondary market or a sale of collateral in essentially the same condition as received upon foreclosure is indeterminate, the creditor likely does not have the information necessary to reasonably estimate cash flows expected and shall cease recognizing income on the financial asset. However, the ability to place a financial asset on nonaccrual shall not be used to circumvent recognition of a credit loss. If the financial asset is acquired primarily for the rewards of ownership of the underlying collateral, accrual of income is inappropriate. Such rewards of ownership would include use of the collateral in operations of the entity or improving the collateral for resale. Consistent with paragraph 310-20-35-18, interest income shall not be recognized to the extent that the net investment in the financial asset would increase to an amount greater than the payoff amount.

Subsequent to initial measurement, an entity determines the estimate of credit losses using the same model as other AFS debt securities. Subsequent changes in the allowance for credit losses for PCD AFS debt securities are recorded as credit loss expense (or reversal), except that an entity may present the change in present value related to the passage of time as interest income (see section 23.3.10). [326-30-35-16, 45-3]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 19.8.20** Can an entity place a purchased AFS debt security with credit deterioration on nonaccrual status?

**Interpretive response:** It depends. An entity applies nonaccrual policies to PCD assets when it does not have a reasonable expectation about the amounts expected to be collected. However, placing a financial asset on nonaccrual status cannot be used to circumvent recognition of a credit loss. [310-10-35-53C]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 20. Beneficial interests

## Detailed contents

Item significantly updated in this edition: #

**20.1 How the standard works**

**20.2 Scope of Subtopic 325-40**

20.2.10 Overview

**Questions**

**Question 20.2.10** What does 'high credit quality' mean when determining whether a beneficial interest is in the scope of Subtopic 325-40?

**Question 20.2.20** Is a beneficial interest initially considered of high credit quality included in the scope of Subtopic 325-40 if the credit quality subsequently declines?

**20.3 Initial measurement**

20.3.10 Overview

20.3.20 PCD beneficial interests

20.3.30 Beneficial interests that are not PCD

**Questions**

**Question 20.3.10** Why is a beneficial interest accounted for as a PCD beneficial interest when there is a significant difference between its contractual and expected cash flows?

**Question 20.3.20** Could beneficial interests other than residual interests have a significant difference between their contractual and expected cash flows?

**Question 20.3.30** How are contractual cash flows determined when evaluating whether the PCD guidance should be applied to a beneficial interest that does not have specified contractual cash flows?

**Question 20.3.40** What prepayment assumptions should be used when determining a beneficial interest's contractual cash flows?

**Example**

**Example 20.3.10** Initial measurement of PCD beneficial interests

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 20.4 Subsequent measurement

20.4.10 Credit losses

20.4.20 Accretion

20.4.30 Writeoffs and recoveries

### Questions

**Question 20.4.10** Is a change in the timing of cash flows considered when evaluating whether there has been a favorable or adverse change in cash flows expected to be collected?

**Question 20.4.20** How is the effective interest rate recalculated when an adverse change in expected cash flows is not reflected as an increase in the allowance?#

### Example

**Example 20.4.10** Subsequent measurement of PCD beneficial interests

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 20.1 How the standard works

This chapter addresses the scope of Subtopic 325-40 and how to account for credit losses on beneficial interests that are in the scope of Subtopic 325-40, including how changes in credit losses affect accretable yield.

The appropriate accounting treatment for beneficial interests depends on whether they are classified as HTM or AFS and whether they are purchased financial assets with credit deterioration (PCD) beneficial interests.

The credit loss guidance on PCD financial assets applies to a beneficial interest that meets the definition of PCD or that has a significant difference between contractual and expected cash flows at the date of recognition.

The following table summarizes the four different accounting models applicable to beneficial interests that are in the scope of Subtopic 325-40.

| Beneficial interests classification | Accounting for PCD assets is applied | Accounting for PCD assets is *not* applied |
|---|---|---|
| **Held-to-maturity** | Initial estimate of expected credit losses is recognized as an allowance through a gross-up that increases the amortized cost basis of the asset with no effect on net income at initial recognition.<br>Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If a favorable change in expected cash flows is not fully recognized through a decrease to the allowance (including a negative allowance), the accretable yield is adjusted on a prospective basis. | No allowance is recognized at initial recognition.<br>Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If a favorable change in expected cash flows is not fully recognized through a decrease to the allowance (including a negative allowance), the accretable yield is adjusted on a prospective basis. |
| **Available-for-sale** | Initial estimate of expected credit losses is recognized as an allowance through a gross-up that increases the amortized cost basis of the asset with no effect on net income at initial recognition.<br>Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If the allowance has been reduced to zero (due to favorable changes) or met the fair value floor (due to adverse changes), the accretable yield is adjusted on a prospective basis. | No allowance is recognized at initial recognition.<br>If a decline in fair value below amortized cost results from credit losses, an allowance is recognized through net income. Subsequent favorable or adverse changes in expected cash flows first decrease or increase the allowance for credit losses. If the allowance has been reduced to zero (due to favorable changes) or met the fair value floor (due to adverse changes), the accretable yield is adjusted on a prospective basis. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 20.2 Scope of Subtopic 325-40

## 20.2.10 Overview

### Excerpt from ASC 325-40

> Instruments

**15-2** The guidance in this Subtopic applies to a transferor's interests in securitization transactions that are accounted for as sales under Topic 860 and purchased **beneficial interests** in securitized financial assets.

**15-3** The guidance in this Subtopic applies to beneficial interests that have all of the following characteristics:

a. Are either debt securities under Subtopic 320-10 or required to be accounted for like debt securities under that Subtopic pursuant to paragraph 860-20-35-2.
b. Involve securitized financial assets that have contractual cash flows (for example, loans, receivables, debt securities, and guaranteed lease residuals, among other items). Thus, the guidance in this Subtopic does not apply to securitized financial assets that do not involve contractual cash flows (for example, common stock equity securities, among other items). See paragraph 320-10-35-38 for guidance on beneficial interests involving securitized financial assets that do not involve contractual cash flows.
c. Do not result in consolidation of the entity issuing the beneficial interest by the holder of the beneficial interests.
d. Subparagraph superseded by Accounting Standards Update No. 2016-13.
e. Are not beneficial interests in securitized financial assets that have both of the following characteristics:
    1. Are of high credit quality (for example, guaranteed by the U.S. government, its agencies, or other creditworthy guarantors, and loans or securities sufficiently collateralized to ensure that the possibility of credit loss is remote)
    2. Cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its recorded investment.

Beneficial interests are rights to receive all or portions of specified cash inflows received by a trust or other entity. These cash flows can include senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through; premiums due to guarantors; commercial paper obligations; and residual interests, whether in the form of debt or equity. [325-40 Glossary]

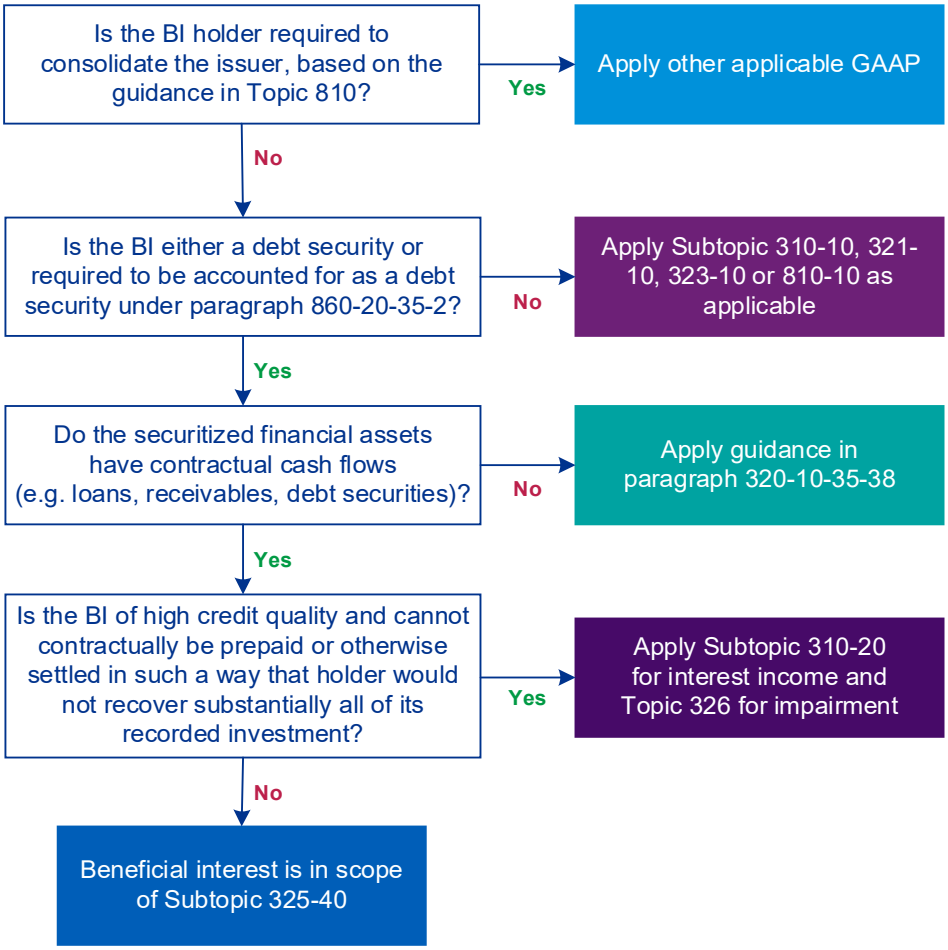
There are two types of beneficial interests in the scope of Subtopic 325-40:

- beneficial interests obtained by a transferor in a securitization transaction that is accounted for as a sale under Topic 860; and
- purchased beneficial interests, including beneficial interests purchased with deteriorated credit quality.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Subtopic 325-40 does not apply to a transferor's beneficial interest in a securitization transaction treated as a secured borrowing. This is because in a secured borrowing, the transferor continues to report the transferred financial asset – rather than the beneficial interest – on its balance sheet. [325-40-15-2 – 15-3]

There are additional requirements that a beneficial interest needs to satisfy to be in the scope of Subtopic 325-40. Those requirements are reflected in the following decision tree. [325-40-15-3]




## **Question 20.2.10** What does 'high credit quality' mean when determining whether a beneficial interest is in the scope of Subtopic 325-40?

**Interpretive response:** Subtopic 325-40 does not apply to a beneficial interest that is of high credit quality and not contractually prepayable or otherwise settleable in a way that the holder would not recover substantially all of its recorded investment. [325-40-15-3(e)]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

We believe the definition of high credit quality, as that term is used in paragraph 325-40-15-3(e), includes only beneficial interests rated AA or better or unrated securities that have credit quality similar to securities rated AA or better.

Paragraph 325-40-15-3(e)(1) includes examples of beneficial interests in securitized financial assets considered to be of high credit quality, such as:

- securities guaranteed by the US government, its agencies or other creditworthy guarantors; and
- loans or securities sufficiently collateralized to ensure that the possibility of credit loss is remote.

According to an SEC staff speech, it appeared to the staff that the EITF intended this guidance to exclude from the scope of Subtopic 325-40 only those beneficial interests for which the likelihood of loss is remote. The SEC staff has indicated that an AA rating is defined by the rating agencies as "the obligor's capacity to meet its financial commitment on the obligation is very strong." This definition is consistent with the possibility of credit loss being remote. In contrast, credit ratings lower than AA are not consistent with this possibility. Therefore, the SEC staff believes that only beneficial interests rated AA or better should be deemed to be of high credit quality for purposes of applying the scope language in paragraph 325-40-15-3(e). [2003 AICPA Conf]

## **Question 20.2.20** Is a beneficial interest initially considered of high credit quality included in the scope of Subtopic 325-40 if the credit quality subsequently declines?

**Interpretive response:** Potentially. On acquisition, an entity assesses a beneficial interest in securitized financial assets to determine whether it is in the scope of Subtopic 325-40. However, Section 325-40-15 does not specify whether an entity should reevaluate this assessment after acquisition for subsequent adverse events, such as a decline in credit quality or market price.

In our experience, entities have interpreted this issue differently and have developed policies on the application of Section 325-40-15 after acquisition. The following are the common methods for assessing whether beneficial interests in securitized financial assets are in the scope of Subtopic 325-40.

| Assessment method | Application | KPMG commentary |
|---|---|---|
| **One-time assessment** | Determine if a beneficial interest is in the scope of Subtopic 325-40 at the date of acquisition and do not reassess based on future events. | |
| **Assessment at acquisition and upon recognition of credit losses (AFS beneficial interests only)** | Determine if a beneficial interest is in the scope of Subtopic 325-40 at the date of acquisition and reassess only on the | This method is not available for beneficial interests that are HTM because an allowance for credit losses is recognized |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Assessment method | Application | KPMG commentary |
|---|---|---|
| | date(s) credit losses are recognized under Subtopic 326-30. | at acquisition. Therefore, it applies only to AFS beneficial interests. |
| **Continuous assessment** | Determine if a beneficial interest is in the scope of Subtopic 325-40 at the date of acquisition and reassess at each reporting date. | We generally believe that the continuous assessment policy is preferable. |

An entity should document and consistently apply its assessment policy. It should also disclose its policy in its financial statement notes. An entity should not change its elected policy related to the application of its assessment unless it is changing to a preferable policy. We generally believe that applying the 'continuous assessment' policy is preferable.

Lastly, because the reevaluation of whether a beneficial interest is in the scope of Subtopic 325-40 is not an acquisition, a beneficial interest cannot be accounted for as PCD as a result of an entity's reassessment of whether it is in the scope of Subtopic 325-40.

## 20.3 Initial measurement

### Excerpt from ASC 325-40

> Initial Investment

**30-1** If the holder of the **beneficial interest** is the transferor, the initial investment would be the fair value of the beneficial interest as of the date of transfer, as required by paragraph 860-20-30-1.

**30-1A** An entity shall apply the initial measurement guidance for **purchased financial assets with credit deterioration** in Subtopic 326-20 to a beneficial interest classified as held-to-maturity and in Subtopic 326-30 to a beneficial interest classified as available-for-sale, if it meets either of the following conditions.

a. There is a significant difference between contractual cash flows and expected cash flows at the date of recognition.
b. The beneficial interests meet the definition of purchased financial assets with credit deterioration.

> Accretable Yield

**30-2** For beneficial interests that do not apply the accounting for purchased financial assets with credit deterioration, the holder shall measure accretable yield initially as the excess of *all cash flows expected to be collected* attributable to the beneficial interest estimated at the acquisition-transaction date (the transaction date) over the initial investment. For beneficial interests that apply the accounting for purchased financial assets with credit deterioration, the holder shall measure accretable yield initially as the excess of

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

all contractual cash flows attributable to the beneficial interest at the acquisition-transaction date (the transaction date) over the amortized cost basis (the purchase price plus the initial allowance for credit losses).

**30-3** At the transaction date, *all cash flows expected to be collected* means the holder's estimate of the amount and timing of estimated future principal and interest cash flows used in determining the purchase price or the holder's fair value determination for purposes of determining a gain or loss under Topic 860.

## 20.3.10 Overview

The initial measurement of beneficial interests in the scope of Subtopic 325-40 depends on whether these interests are treated as PCD. The following beneficial interests are treated as PCD and therefore are referred to as 'PCD beneficial interests'. [325-40-30-1A]

- Beneficial interests that meet the definition of PCD – i.e. those that have experienced a more-than-insignificant deterioration in credit quality since origination (see chapter 12).
- Beneficial interests that have a significant difference between contractual cash flows and expected cash flows at the date of recognition.

## 20.3.20 PCD beneficial interests

PCD beneficial interests are initially measured using the 'gross-up' method used for PCD assets in general. The gross-up method (described below) is applied to a PCD beneficial interest regardless of whether it is classified as HTM or AFS. [326-20-30-13, 326-30-30-2]

Under the gross-up method, the initial estimate of expected credit losses is recognized as an allowance and there is no Day 1 credit loss expense. The initial amortized cost basis of a PCD beneficial interest is determined as follows.

At acquisition, the accretable yield is measured as the excess of all contractual cash flows attributable to the beneficial interest over the amortized cost basis. This amount is not presented on the balance sheet. [325-40-30-2, 45-1]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 20.3.10** Why is a beneficial interest accounted for as a PCD beneficial interest when there is a significant difference between its contractual and expected cash flows?

**Interpretive response:** The FASB concluded that beneficial interests that have a significant difference between contractual and expected cash flows should be subject to the guidance for PCD assets because these interests pose the same core issue as PCD assets. In the FASB's view, it would be inappropriate to recognize interest income on the basis of contractual cash flows when a significant portion of those cash flows is not expected to be collected. As a result, the FASB decided that certain beneficial interests should qualify for the gross-up method at acquisition even if they do not meet the definition of a PCD asset because there has not been any credit deterioration since origination. [ASU 2016-13.BC94–BC95]

## **Question 20.3.20** Could beneficial interests other than residual interests have a significant difference between their contractual and expected cash flows?

**Interpretive response:** Yes. Subtopic 325-40 does not provide guidance on how to determine whether a difference between contractual and expected cash flows is 'significant'.

As a result, this determination will require judgment.

- 'Residual interest' is a term used to refer to the most subordinated interests in securitized financial assets that are issued by a trust or other entity. Typically, the holders of the residual interest are entitled to receive cash flows after contractually specified cash flows have been paid to all other interest holders. Residual interests are likely to have a significant difference between their contractual and expected cash flows (see also Question 20.3.30).
- Additionally, interests other than residual interests should be evaluated to determine whether there is a significant difference between their contractual and expected cash flows.

## **Question 20.3.30** How are contractual cash flows determined when evaluating whether the PCD guidance should be applied to a beneficial interest that does not have specified contractual cash flows?

**Interpretive response:** When evaluating whether the PCD guidance should be applied to beneficial interests, Subtopic 325-40 does not provide guidance on how to determine whether there is a significant difference between contractual and expected cash flows when the instrument itself does not have contractual

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

cash flows – e.g. when a beneficial interest holder is entitled to receive only the residual cash flows of a securitization structure.

If contractual cash flows of a beneficial interest are not specified, a holder should look through to the contractual cash flows of the underlying financial assets and determine what cash flows would be paid to the holder of that beneficial interest if all of the underlying assets paid in accordance with their contractual terms. Additionally, as explained in Question 20.3.40, a holder should consider expected prepayment of the underlying financial assets when determining contractual cash flows. [TRG 06-17.6]

The holder would then compare the contractual cash flows with the cash flows expected to be collected to determine whether there is a significant difference between contractual and expected cash flows at acquisition. If a significant difference exists, the PCD guidance should be applied.

## **Question 20.3.40** What prepayment assumptions should be used when determining a beneficial interest's contractual cash flows?

**Interpretive response:** The holder's expected prepayment assumptions at acquisition should be used.

The TRG discussed how prepayments should be considered when determining contractual cash flows for purposes of:

- assessing whether beneficial interests meet the scope to be PCD beneficial interests; and
- initially estimating expected credit losses for PCD beneficial interests.

For both of the above purposes, the TRG generally agreed that contractual cash flows should consider the holder's initial expectations for prepayments. However, contractual cash flows should not consider any expected credit losses.

A beneficial interest is a PCD beneficial interest if there is a significant difference between contractual and expected cash flows. The impact of including initially expected prepayments in the determination of contractual cash flows will generally result in fewer beneficial interests being considered PCD beneficial interests.

The initial estimation of expected credit losses reflects the difference between contractual cash flows and expected cash flows. Expected cash flows are required to consider expected prepayments. By also considering expected prepayments in contractual cash flows, the initial estimate of expected credit losses will not be impacted by expected prepayments. As a result, the allowance for credit losses will generally be smaller than if prepayments were not considered in contractual cash flows. [TRG 06-17.2, TRG 06-17.6]

Additionally, the TRG noted that although expected prepayments should not be included in the initial estimation of expected credit losses, all subsequent changes in expected cash flows (due to both credit and prepayments) should be included in the estimation of expected credit losses in future periods. Subsequent favorable (or unfavorable) changes in expected cash flows first

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

decrease (or increase) the allowance. If the allowance is reduced to zero or – for AFS debt securities – has met the fair value floor, the accretable yield is adjusted on a prospective basis.

## **Example 20.3.10** Initial measurement of PCD beneficial interests

ABC Corp. acquires a beneficial interest in a residual tranche of a securitization structure that meets the conditions to be in the scope of Subtopic 325-40. ABC classifies the beneficial interest as AFS.

ABC pays $700,000 to the seller and determines that there is a significant difference between expected cash flows and the contractual cash flows attributable to the residual tranche based on the underlying financial assets that were securitized. Assume that there are no embedded derivatives that need to be bifurcated and accounted for separately.

ABC uses discounted cash flows to estimate expected credit losses, as required by Subtopic 325-40 (see section 20.4.10). It determines the EIR – which is the rate that equates the present value of expected cash flows at acquisition with the purchase price of $700,000 – to be 9.29% (rounded). ABC uses the 9.29% EIR to discount expected credit losses and determines the allowance for credit losses at the time of acquisition is $175,000.

The following table reflects:

- contractual cash flows attributable to the residual tranche based on the underlying securitized financial assets, assuming zero credit losses and considering expected prepayments;
- ABC's initial cash flow expectations, considering both expected credit losses and prepayments; and
- expected credit losses at the date of acquisition.

| Year | Contractual cash flows | Expected cash flows | Expected credit losses[1] |
|---|---|---|---|
| 1 | 280,000 | 224,000 | 56,000 |
| 2 | 300,000 | 240,000 | 60,000 |
| 3 | 260,000 | 208,000 | 52,000 |
| 4 | 180,000 | 144,000 | 36,000 |
| 5 | 65,881 | 52,705 | 13,176 |
| Total | 1,085,881 | 868,705 | 217,176 |
| Purchase price | | 700,000 | |
| Original EIR (rounded) | 9.29% | | 9.29% |
| Present value at EIR | 875,000 | | 175,000 |
| Accretable yield (non-credit discount) | 210,881 | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Note:
1. Expected credit losses represent cash flows *not* expected to be collected.

ABC records the following journal entry to account for the acquisition of the beneficial interest.

| | Debit | Credit |
|---|---|---|
| Beneficial interests – AFS | 1,085,881 | |
| Cash | | 700,000 |
| Allowance for credit losses | | 175,000 |
| Beneficial interests – AFS – non-credit discount (accretable yield) | | 210,881 |
| *To record acquisition of beneficial interests, estimate of expected credit losses and non-credit discount (accretable yield).* | | |

The non-credit discount (accretable yield) of $210,881 is the difference between all contractual cash flows attributable to the beneficial interest at the transaction date ($1,085,881) and the amortized cost basis ($875,000 – i.e. purchase price plus the initial allowance for credit losses).

Immediately after acquisition, ABC's balance sheet reflects the following.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Beneficial interests – AFS (amortized cost of $875,000, allowance for credit losses of $175,000) | 700,000 |

The beneficial interests are presented net of the non-credit discount as the accretable yield is not permitted to be presented on the balance sheet. [325-40-45-1]

## 20.3.30 Beneficial interests that are not PCD

Beneficial interests for which PCD accounting is not applied are initially measured at fair value. [325-40-30-1]

At acquisition, the accretable yield is initially measured as the excess of all cash flows expected to be collected attributable to the beneficial interest over the fair value. Cash flows expected to be collected include estimates of both the amount and timing of principal and interest payments to be received. [325-40-30-2, 35-3]

As further discussed in section 20.4.10, Subtopic 325-40 requires an entity to use a discounted cash flow method to estimate expected credit losses for all investments in beneficial interests in its scope; this is regardless of whether they are classified as HTM or as AFS. Additionally, it requires an entity to recognize credit losses when there has been an adverse change in the net present value of cash flows expected to be collected when compared to net present value of cash flows expected at the date of initial recognition. As a

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

result, an entity will not recognize an allowance for credit losses at initial recognition of beneficial interests that are not PCD because there will not have been an adverse change at that time. [325-40-35-6 – 35-7]

## 20.4 Subsequent measurement

### Excerpt from ASC 325-40

> Accretable Yield

**35-1** The holder shall recognize accretable yield as interest income over the life of the **beneficial interest** using the effective yield method. Under the effective yield method, the current yield is applied to the amount determined as the initial investment (or initial amortized cost basis for beneficial interests that apply the accounting for **purchased financial assets with credit deterioration**) minus cash received to date minus writeoff of amortized cost basis plus the yield accreted to date. The holder of a beneficial interest shall continue to update, over the life of the beneficial interest, the expectation of cash flows to be collected.

**35-3** After the transaction date, cash flows expected to be collected are defined as the holder's estimate of the amount and timing of estimated principal and interest cash flows based on the holder's best estimate of current conditions and reasonable and supportable forecasts.

**35-4** If upon evaluation of a held-to-maturity classified beneficial interest there is a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected, the investor shall first apply the guidance in Subtopic 326-20 on financial instruments measured at amortized cost to account for that favorable (or adverse) change. After application of the guidance in Subtopic 326-20, if the amount of the favorable (or adverse) change in cash flows expected to be collected from the cash flows previously projected is not reflected (either as an increase or as a decrease) in the allowance for credit losses in accordance with Subtopic 326-20, the investor shall recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of cash flows expected to be collected over the beneficial interest's reference amount. The investor shall recalculate the current yield on the date of the evaluation as the rate that equates the cash flows expected to be collected to the beneficial interest's reference amount.

**35-4A** If upon evaluation of an available-for-sale classified beneficial interest there is a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected, the investor shall apply the guidance in Subtopic 326-30 on measuring credit losses on available-for-sale debt securities to account for that favorable (or adverse) change. After application of the guidance in Subtopic 326-30, if the amount of the favorable (or adverse) change in cash flows expected to be collected from the cash flows previously projected is not reflected (either as an increase or as a decrease) in the allowance for credit losses in accordance with Subtopic 326-30, the investor shall recalculate the amount of accretable yield for the beneficial interest on the date of evaluation as the excess of cash flows expected to be

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

collected over the beneficial interest's reference amount. The investor shall recalculate the current yield on the date of the evaluation as the rate that equates the cash flows expected to be collected to the beneficial interest's reference amount.

**35-4B** The reference amount in paragraphs 325-40-35-4 through 35-4A is equal to the initial investment (or initial amortized cost basis for beneficial interests that apply the accounting for purchased financial assets with credit deterioration) minus cash received to date minus writeoff of amortized cost basis minus the allowance for credit losses plus the yield accreted to date.

**35-4C** In this Subtopic, a favorable (or an adverse) change in cash flows expected to be collected is considered in the context of both timing and amount of the cash flows expected to be collected. Based on cash flows expected to be collected, interest income may be recognized on a beneficial interest even if the net investment in the beneficial interest is accreted to an amount greater than the amount at which the beneficial interest could be settled if prepaid immediately in its entirety. The adjustment shall be accounted for prospectively as a change in estimate in conformity with Topic 250, with the amount of periodic accretion adjusted over the remaining life of the beneficial interest.

**35-5** Determining whether there has been a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected (taking into consideration both the timing and amount of the cash flows expected to be collected) involves comparing the present value of the remaining cash flows expected to be collected at the initial transaction date (or at the last date previously revised) against the present value of the cash flows expected to be collected at the current financial reporting date.

**35-6** The cash flows shall be discounted at a rate equal to the current yield used to accrete the beneficial interest.

> Credit Losses

**35-6A** An entity shall account for credit losses on beneficial interests classified as held to maturity and available for sale in accordance with Topic 326.

**35-7** An entity shall use the present value of expected future cash flows technique to measure credit losses on beneficial interests. If the present value of the original estimate at the initial transaction date (or the last date previously revised) of cash flows expected to be collected is less than the present value of the current estimate of cash flows expected to be collected, the change is considered favorable. If the present value of the original estimate at the initial transaction date (or the last date previously revised) of cash flows expected to be collected is greater than the present value of the current estimate of cash flows expected to be collected, the change is considered adverse.

## 20.4.10 Credit losses

Credit losses on beneficial interests are determined under the guidance in either Subtopic 326-20 (if they are classified as HTM) or Subtopic 326-30 (if they are classified as AFS). However, while 326-20 provides latitude in choosing a

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

method to estimate expected credit losses, Subtopic 325-40 requires an entity to use a discounted cash flow method to estimate expected credit losses for all investments in beneficial interests within its scope, regardless of whether they are classified as HTM or as AFS. The discount rate used in estimating expected credit losses is the same as the rate used for recognizing interest income for these types of instruments. Otherwise, all other aspects of the credit loss models in Subtopics 326-20 and 326-30 are applied to beneficial interests in the scope of Subtopic 325-40. [325-40-35-6 – 35-7]

See chapters 3 to 8 and chapter 19 for measurement guidance regarding HTM and AFS debt securities, respectively.

## 20.4.20 Accretion

The accretable yield determined at acquisition is recognized as interest income over the life of the beneficial interest. Favorable (or adverse) changes in expected cash flows on beneficial interests subsequent to initial recognition first decrease (or increase) the allowance for credit losses. The accretable yield is adjusted on a prospective basis if either: [325-40-35-1, 35-4 – 35-4A]

- a favorable change in expected cash flows has reduced the allowance for credit losses to zero for AFS beneficial interests or to the limit of the negative allowance for HTM beneficial interests (see section 20.4.30); or
- an adverse change has increased the allowance such that the amortized cost has reached the fair value floor for AFS beneficial interests – i.e. the allowance is limited to the amount by which the amortized cost basis exceeds the fair value. For additional information on the fair value floor, see chapter 19.

### **Question 20.4.10** Is a change in the timing of cash flows considered when evaluating whether there has been a favorable or adverse change in cash flows expected to be collected?

**Interpretive response:** Yes. Both the amount and timing of cash flows are considered when determining whether there has been a favorable or adverse change in the cash flows expected to be collected in periods subsequent to initial recognition. Therefore, prepayments or a change in prepayment speeds may affect an entity's estimate of cash flows expected to be collected. [325-40-35-4C]

Additionally, any actual or estimated deferral in the receipt of the cash flows results in an unfavorable change if: [325-40-35-4C]

- the entity receives no interest on the deferred cash flows; or
- the accretion rate – used to discount the cash flows expected to be collected – is higher than the interest rate received on the deferred cash flows.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Example 20.4.10** Subsequent measurement of PCD beneficial interests

Continuing Example 20.3.10, ABC Corp. subsequently accounts for the AFS beneficial interest from Year 1 to Year 5 of its life as follows.

ABC does not exclude accrued interest receivable from the fair value and amortized cost basis of the AFS beneficial interest and, accordingly, measures an allowance for credit losses for accrued interest receivable. Further, ABC writes off accrued interest receivable by reversing the previously recognized allowance (see Question 4.2.50).

The following table represents the projected amortization schedule for the amortized cost of the beneficial interest – which is net of the accretable yield – based on ABC's initial expected cash flows at acquisition.

| Year | Amortized cost beginning balance[1] | Cash payments[2] | Interest income[3] | Writeoffs[4] | Amortized cost ending balance[5] |
|---|---|---|---|---|---|
| 1 | 875,000 | 224,000 | 81,269 | 56,000 | 676,269 |
| 2 | 676,269 | 240,000 | 62,811 | 60,000 | 439,080 |
| 3 | 439,080 | 208,000 | 40,781 | 52,000 | 219,861 |
| 4 | 219,861 | 144,000 | 20,421 | 36,000 | 60,282 |
| 5 | 60,282 | 52,705 | 5,599 | 13,176 | 0 |
| Total | | 868,705 | 210,881 | 217,176 | |

Notes:

1. Amortized cost at acquisition is the sum of the purchase price and the initial allowance for expected credit losses ($700,000 + $175,000).
2. Cash payments reflect expected cash flows.
3. Interest income is calculated as beginning amortized cost balance × the EIR of 9.29% (rounded).
4. Amounts written off reflect expected writeoffs of amounts deemed uncollectible.
5. Amortized cost ending balance = amortized cost beginning balance + interest income – cash payments – writeoffs.

The following table represents the projected roll-forward of the allowance for credit losses based on ABC's initial expected cash flows at acquisition.

| Year | Allowance for credit losses beginning balance | Change in present value due to passage of time[1] | Changes in present value due to changes in expected cash flows | Writeoffs | Allowance for credit losses ending balance[2] |
|---|---|---|---|---|---|
| 1 | 175,000 | 16,254 | 0 | 56,000 | 135,254 |
| 2 | 135,254 | 12,562 | 0 | 60,000 | 87,816 |
| 3 | 87,816 | 8,156 | 0 | 52,000 | 43,972 |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Year | Allowance for credit losses beginning balance | Change in present value due to passage of time[1] | Changes in present value due to changes in expected cash flows | Writeoffs | Allowance for credit losses ending balance[2] |
|---|---|---|---|---|---|
| 4 | 43,972 | 4,084 | 0 | 36,000 | 12,056 |
| 5 | 12,056 | 1,120 | 0 | 13,176 | 0 |
| Total | | 42,176 | 0 | 217,176 | |

Notes:

1. Represents the periodic effect on the allowance due to the passage of time, calculated as the beginning balance of the allowance × the EIR of 9.29% (rounded). ABC may present this either as credit loss expense or as a reduction of interest income. [326-20-45-3]
2. Ending balance = beginning balance + change in the present value due to both passage of time and to changes in expected cash flows – writeoffs.

The difference between expected cash flows of $868,705 and the purchase price of $700,000 is $168,705. This amount represents the time value of money, which, based on initial expected cash flows, would be reflected in the income statement as:

- $210,881 accretable yield recognized through interest income;
- $42,176 cumulative change in present value of expected credit losses, which may be presented either as credit loss expense or as a reduction of interest income.

For simplicity, it is assumed that actual cash flows during Year 1 were the same as the initial expected cash flows. At the end of the Year 1, the fair value of the residual interest is $504,835 and ABC updates its estimate of expected cash flows.

The following table reflects ABC's updated expectations.

| Year | Contractual cash flows | Expected cash flows | Expected credit losses | Increase (decrease) in expected cash flows |
|---|---|---|---|---|
| 2 | 300,000 | 230,000 | 70,000 | (10,000) |
| 3 | 260,000 | 200,000 | 60,000 | (8,000) |
| 4 | 180,000 | 140,000 | 40,000 | (4,000) |
| 5 | 65,881 | 50,000 | 15,881 | (2,705) |
| Total | 805,881 | 620,000 | 185,881 | (24,705) |
| Original EIR (rounded) | 9.29% | 9.29% | 9.29% | 9.29% |
| Present value at EIR (rounded) | 676,269 | 520,207 | 156,062 | (20,808) |
| Remaining accretable yield | 129,612 | | | |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The decrease in expected cash flows before the effect of discounting ($24,705) represents the difference between the updated estimate of expected credit losses at the end of Year 1 ($185,881) and the initial estimate of expected credit losses at acquisition for Years 2 through 5 ($161,176) (see Example 20.3.10).

The following table represents the projected amortization schedule for the amortized cost of the beneficial interest – which is net of the accretable yield – based on ABC's expected cash flows at the end of Year 1.

| Year | Amortized cost beginning balance[1] | Cash payments[2] | Interest income[3] | Writeoffs[4] | Amortized cost ending balance[5] |
|---|---|---|---|---|---|
| 1 (actual) | 875,000 | 224,000 | 81,269 | 56,000 | 676,269 |
| 2 | 676,269 | 230,000 | 62,811 | 70,000 | 439,080 |
| 3 | 439,080 | 200,000 | 40,781 | 60,000 | 219,861 |
| 4 | 219,861 | 140,000 | 20,421 | 40,000 | 60,282 |
| 5 | 60,282 | 50,000 | 5,599 | 15,881 | 0 |

Notes:

1. Amortized cost at acquisition is the sum of the purchase price and the initial allowance for expected credit losses ($700,000 + $175,000).
2. Cash payments reflect expected cash flows.
3. Interest income is calculated as beginning amortized cost balance × the EIR of 9.29% (rounded). This also represents the change in accretable yield.
4. Amounts written off reflect expected writeoffs of amounts deemed uncollectible.
5. Amortized cost ending balance = amortized cost beginning balance + interest income – cash payments – writeoffs.

ABC determines whether there has been a favorable (or an adverse) change in cash flows expected to be collected from the cash flows previously projected. It does this by comparing the present value of the remaining cash flows expected to be collected at the initial transaction date with the present value of the cash flows expected to be collected at the current reporting date.

| Year | Original expected cash flows | Current expected cash flows | Favorable (adverse) change |
|---|---|---|---|
| 2 | 240,000 | 230,000 | (10,000) |
| 3 | 208,000 | 200,000 | (8,000) |
| 4 | 144,000 | 140,000 | (4,000) |
| 5 | 52,705 | 50,000 | (2,705) |
| Total | 644,705 | 620,000 | (24,705) |
| Original EIR (rounded) | 9.29% | 9.29% | 9.29% |
| Present value at EIR | 541,015 | 520,207 | (20,808) |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Because the present value of cash flows expected to be collected has decreased, an adverse change has occurred in the amount of $20,808. Because the change in expected cash flows is adverse, the original EIR continues to be the appropriate discount rate.

ABC applies the guidance in Subtopic 326-30 as follows.

- The security is impaired in the amount of $171,434 because its fair value ($504,835) is less than its amortized cost ($676,269).
- ABC reports in net income the amount necessary to adjust the allowance for credit losses to management's current estimate of expected credit losses of $156,062, subject to the fair value floor. Under the fair value floor, the allowance is limited to the amount by which the amortized cost basis exceeds the fair value – i.e. the maximum allowance to be recorded is $171,434.

ABC reports $15,372 as a charge to other comprehensive income, which represents the amount of impairment that is not reflected as an allowance for credit losses – i.e. impairment of $171,434 less allowance for credit losses of $156,062. Because the entire amount of the adverse change in cash flows expected to be collected is reflected in the allowance for credit losses and does not exceed the fair value floor, no adjustment is necessary to the accretable yield.

The following table represents the projected roll-forward of the allowance for credit losses based on the expected cash flows at the end of Year 1.

| Year | Allowance for credit losses beginning balance | Change in present value due to passage of time[1] | Changes in present value due to changes in expected cash flows[2] | Writeoffs | Allowance for credit losses ending balance[3] |
|---|---|---|---|---|---|
| 1 (actual) | 175,000 | 16,254 | 20,808 | 56,000 | 156,062 |
| 2 | 156,062 | 14,495 | 0 | 70,000 | 100,557 |
| 3 | 100,557 | 9,340 | 0 | 60,000 | 49,897 |
| 4 | 49,897 | 4,634 | 0 | 40,000 | 14,531 |
| 5 | 14,531 | 1,350 | 0 | 15,881 | 0 |

Notes:

1. Represents the periodic effect on the allowance due to the passage of time, calculated as the beginning balance of the allowance × the EIR of 9.29% (rounded). ABC may present this either as credit loss expense or as a reduction of interest income. [326-20-45-3]
2. Represents the periodic effect on the allowance due the changes in expected cash flows.
3. Ending balance = beginning balance + change in the present value due to passage of time and changes in expected cash flows – writeoffs.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

ABC records the following journal entries for Year 1.

| | Debit | Credit |
|---|---|---|
| Beneficial interests – AFS – non-credit discount[1]<br>Interest income[1]<br>*To record interest income at EIR.* | 81,269 | 81,269 |
| Cash<br>Beneficial interests – AFS<br>*To record receipt of cash during Year 1.* | 224,000 | 224,000 |
| Allowance for credit losses<br>Beneficial interests – AFS<br>*To record writeoffs of contractual cash flows.* | 56,000 | 56,000 |
| Credit loss expense[2]<br>Allowance for credit losses<br>*To record changes in present value of estimated credit losses.* | 37,062 | 37,062 |
| Unrealized loss on beneficial interest – AFS (other comprehensive income)[3]<br>Beneficial interests – AFS<br>*To record impairment not reflected in allowance for credit losses.* | 15,372 | 15,372 |

Notes:

1. Calculated as beginning amortized cost of $875,000 × the EIR of 9.29% (rounded). This also represents the change in the accretable yield during the year.
2. ABC elects to report the entire change in present value (including changes due to both passage of time ($16,254) and changes in expected cash flows ($20,808)) as credit loss expense.
3. The amount of total impairment ($171,434) less the portion of impairment recorded through the allowance for credit losses ($156,062). The effect of taxes is disregarded for simplicity.

The following table represents the roll-forward of the carrying amount of the beneficial interest during Year 1.

| Year | Carrying amount beginning balance[1] | Cash payments received | Interest income | Credit loss expense | Unrealized loss (decline in fair value) | Carrying amount ending balance[2] |
|---|---|---|---|---|---|---|
| 1 (actual) | 700,000 | 224,000 | 81,269 | 37,062 | 15,372 | 504,835 |

Notes:

1. Represents amortized cost ($875,000) less the allowance for credit losses ($175,000).
2. Ending balance (which equals fair value) = beginning balance + interest income – cash payments – credit loss expense – unrealized loss.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

At the end of Year 1, ABC's financial statements reflect the following.

| Account | Amount |
|---|---|
| **Balance sheet – assets** | |
| Beneficial interests – AFS (amortized cost of $676,269, allowance for credit losses of $156,062) | 504,835 |
| **Balance sheet – equity** | |
| Other comprehensive income – unrealized loss on beneficial interest AFS for which an allowance for credit losses has been reported | (15,372) |
| **Income statement** | |
| Interest income | 81,269 |
| Credit loss expense | (37,062) |

The beneficial interests are presented net of the non-credit discount because the accretable yield is not permitted to be presented in the balance sheet. [325-40-45-1]

## **Question 20.4.20** How is the effective interest rate recalculated when an adverse change in expected cash flows is not reflected as an increase in the allowance?#

**Background:** When there is an adverse change in cash flows for a beneficial interest, that change is generally reflected as an increase in the allowance. However, when the beneficial interest is an AFS security, there are limits as to how much the allowance can be increased. When a credit loss is recognized through an allowance, the amount of the allowance is limited by the amount that the security's amortized cost basis exceeds the security's fair value – called the 'fair value floor' (see section 19.5.10).

When the allowance has been limited by the fair value floor, the effective interest rate used to recognize interest income is reduced. However, before ASU 2025-12's issuance, Subtopic 325-40 was not clear about how the reduced rate should be calculated. [325-40-35-4A]

**Interpretive response:** When an adverse change in cash flows is not recognized as an increase in the allowance because of the fair value floor limitation, we believe the entity should recalculate the effective interest rate as the rate that equates the cash flows expected to be collected to:

- the AFS beneficial interest's reference amount; for non-PCD beneficial interests this is the initial investment less cash received to date less previous writeoffs plus the yield accreted to date; less
- the allowance for credit losses.

When the allowance has been limited by the fair value floor, the AFS beneficial interest's reference amount less the allowance for credit losses will equal the AFS beneficial interest's fair value. As a result, the rate that equates the cash flows expected to be collected to that amount will be the market interest rate.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

This view is consistent with the amendments to Subtopic 325-40 in ASU 2025-12.

Ordinarily, a beneficial interest is accreted to the cash flows expected to be collected at its acquisition (or for a PCD beneficial interest, to its contractual cash flows). However, when an AFS beneficial interest's effective interest rate is reduced because the fair value floor is triggered, the beneficial interest is accreted to amounts that are less than those original expected cash flows (or for a PCD beneficial interest, to amounts less than the contractual cash flows). As a result, the entity may also need to develop a writeoff policy to consider this effect.

## 20.4.30 Writeoffs and recoveries

Topic 326 requires the recognition of writeoffs of both HTM and AFS debt securities. This guidance also applies to beneficial interests in the scope of Topic 325-40. Because of this new requirement, entities will need to develop new processes, policies and controls addressing the timing of recognition for writeoffs of the allowance for expected credit losses related to beneficial interests, including allowance amounts recognized at acquisition of PCD beneficial interests. [326-20-35-8, 326-30-35-13]

An entity is prohibited from recognizing a negative allowance for credit losses for AFS beneficial interests. In contrast, the allowance for credit losses for HTM beneficial interests may, in limited circumstances, be negative (i.e. a debit balance). This is because the allowance for HTM beneficial interests includes expected recoveries of amounts previously written off (and expected to be written off); see section 3.3.10. [326-20-30-1, 35-8, 326-30-35-12]

The negative allowance for HTM beneficial interests may not exceed amounts previously written off. To the extent favorable changes in expected cash flows are not recognized through a decrease to the allowance for credit losses, including recognizing a negative allowance to the extent of prior write offs, the accretable yield is adjusted on a prospective basis. [325-40-35-4 – 35-4A, 326-20-30-1]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 21. Subsequent events

## Detailed contents

**21.1 How the standard works**

**21.2 Recognition**

21.2.10 Overview

**Questions**

**Question 21.2.10** Does an entity adjust its estimate of credit losses for information received after the reporting date but before the financial statements are issued?

**Question 21.2.20** Must an entity incorporate economic data available through the reporting date in its estimate of credit losses?

**Question 21.2.30** Must an entity incorporate economic data available after the reporting date (but before the financial statements are issued) in its estimate of credit losses?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 21.1 How the standard works

Subsequent events are events or transactions that occur after the reporting date but before the financial statements are issued (or available to be issued). They fall into two categories: [855-10-25-1, 25-3]

- those that provide additional evidence about conditions that existed at the reporting date, including the estimates inherent in the process of preparing financial statements – known as recognized or Type I subsequent events; and
- those that provide evidence about conditions that did not exist at the reporting date but arose subsequent to that date – known as nonrecognized or Type II subsequent events.

An entity recognizes the effect of Type I subsequent events in the financial statements at the reporting date, but does not recognize the effect of Type II subsequent events in the financial statements. The SEC staff has provided its views about whether information received after the reporting date should be considered to be Type I or Type II.

Under Topic 855, changes in estimated credit losses arising after the reporting date but before the financial statements are issued (available to be issued) should not be reflected in the allowance for credit losses at the reporting date.

The guidance in this chapter relates solely to the application of Topic 855 to the estimate of the allowance for expected credit losses and should not be analogized to other circumstances.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 21.2 Recognition

## 21.2.10 Overview

### Excerpt from ASC 855-10

> Nonrecognized Subsequent Events

**55-2** The following are examples of nonrecognized subsequent events addressed in paragraph 855-10-25-3: …

e. Changes in estimated credit losses on receivables arising after the balance sheet date but before financial statements are issued or are available to be issued

…

### Excerpt from SEC staff speech

**Kevin L. Vaughn** [2018 AICPA Conf]

**Evaluating Subsequent Events in the Current Expected Credit Losses Model**

Next, I would like to discuss a recent consultation we received relating to the application of subsequent events guidance[6] following adoption of the new credit losses standard.[7] The consultation submission presented three specific fact patterns that illustrated the unique challenges in applying the subsequent events guidance to the forward-looking estimate of expected credit losses.

As background, with respect to each of these fact patterns, the referenced information was received after the balance sheet date but before the financial statements were issued or were available to be issued. Further, in each fact pattern, the information received was significantly different from management's expectations.

The staff shared its views regarding the appropriate application of US GAAP on the three specific fact patterns as follows.

The first fact pattern related to the receipt of a servicer report that showed the effects of payment experience (e.g., delinquencies and prepayments) that occurred on or before the balance sheet date. The second fact pattern related to the receipt of an appraisal report that showed information about the fair value of loan collateral as of the balance sheet date. In both of these fact patterns, the staff indicated we would object to a registrant not considering this information in its estimate of expected credit losses. An important consideration in both of these fact patterns was that this information was loan-specific information about factual conditions that existed at the balance sheet date.

The third fact pattern related to the U.S. government's announcement of unemployment rates for a period that includes the balance sheet date. The staff indicated that we would not object to a registrant either considering or not considering such rates in its estimate of expected credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

In connection with these three conclusions, we shared our view that in connection with the forward-looking estimate of expected credit losses, there can be recognized and nonrecognized subsequent events.

I understand registrants and auditors have continued to engage in discussions to evaluate how a registrant will consider other potential fact patterns that could arise. While registrants will ultimately of course need to consider materiality and their specific facts and circumstances, I thought it might be helpful to share my views regarding how certain types of information received after the balance sheet date but before financial statements are issued or are available to be issued could be evaluated:

- Loan-specific information about factual conditions that existed at the balance sheet date, such as the servicer reports and appraisal reports I mentioned earlier, would be recognized;
- Information relating to forecasting assumptions used in establishing expected credit losses that is received before the registrant has completed an appropriate estimation process would be permitted to be included in the estimate, unless such information indicates a weakness or a deficiency in the registrant's estimation process, in which case the information would be recognized; and
- Information relating to forecasting assumptions used in establishing expected credit losses that is received after the registrant has completed an appropriate estimation process would not be recognized, unless such information indicates a weakness or a deficiency in the registrant's estimation process, in which case the information would be recognized.

As a reminder, Topic 855 includes required disclosures for nonrecognized subsequent events.[8]

Notes:

…

[6] ASC Topic 855.

[7] ASU No. 2016-13 included amendments to Topic 855 to reflect the change from an incurred loss model to an expected credit loss model. These amendments did not change the principle for determining a subsequent event that should be recognized in the financial statements.

[8] See ASC 855-10-50-2 and 855-10-50-3.

Under Subtopic 855-10, changes in estimated credit losses on receivables arising after the reporting date but before the financial statements are issued (available to be issued) are not reflected in the allowance for credit losses at the reporting date. However, Subtopic 855-10 does not include examples to illustrate whether information received after the reporting date should be reflected in an entity's estimate of lifetime expected credit losses model as of the reporting date. [855-10-55-2(e)]

The guidance in this chapter relates solely to the application of Topic 855 to the estimate of the allowance for expected credit losses and should not be analogized to other circumstances.

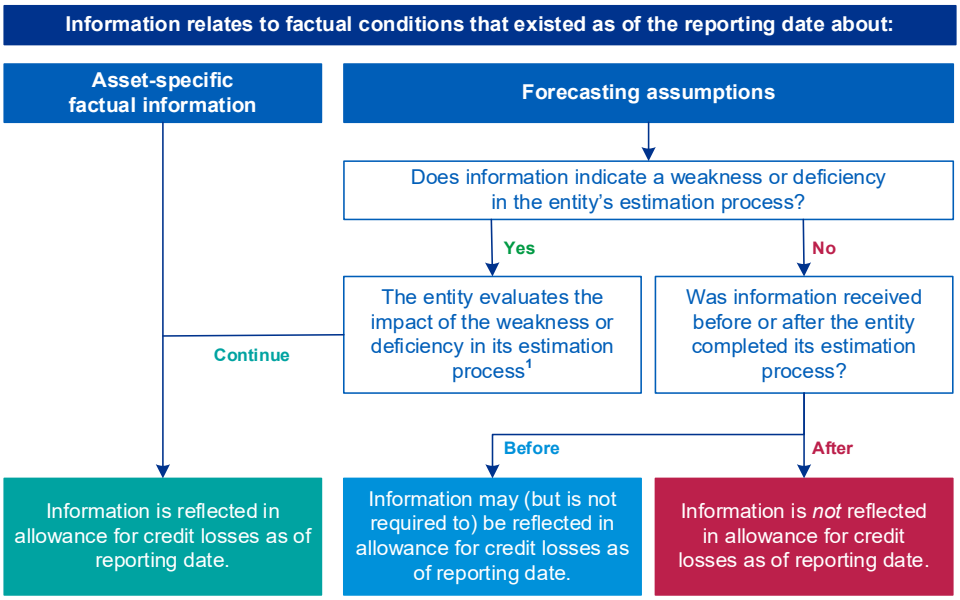
© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 21.2.10** Does an entity adjust its estimate of credit losses for information received after the reporting date but before the financial statements are issued?

**Interpretive response:** It depends. The SEC staff addressed this issue in a speech at the 2018 AICPA Conference on Current SEC and PCAOB Developments. The SEC staff indicated that whether information received after the reporting date should be reflected in the financial statements depends on whether: [2018 AICPA Conf]

- the information is loan-specific information about factual conditions that existed at the reporting date or relates to forecasting assumptions; and
- information related to forecasting assumptions was received before (or after) the entity has completed an appropriate process for estimating expected credit losses.

The following flowchart summarizes these considerations. [2018 AICPA Conf]




Note:

1. If an entity concludes there was a weakness or other breakdown in its estimation process, we believe the entity also considers:
   - the scope of the breakdown(s) in the process and whether there are other adjustments that should be made to the estimate;
   - whether there were also breakdown(s) in previous periods; and
   - whether a deficiency(ies) exists in related internal controls over financial reporting and the severity of the deficiency(ies).

The following table includes examples of the nature of certain types of information received – i.e. whether the information is asset-specific information about factual conditions that existed at the reporting date or relates to forecasting assumptions.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Information received | Nature of information |
|---|---|
| **Servicer report** | A servicer report that reflects payment experience (i.e. delinquencies and prepayments) that occurred on or before the reporting date is asset-specific information about factual conditions that existed at the reporting date and should be reflected in the estimate of expected credit losses. [2018 AICPA Conf] |
| **Collateral appraisal** | An appraisal that reports on the fair value of collateral underlying a financial asset as of the reporting date is asset-specific information about factual conditions that existed at the reporting date and should be reflected in the estimate of expected credit losses. [2018 AICPA Conf] |
| **Economic data** | Economic data (e.g. announcements by the U.S. government of unemployment rates) relates to forecasting assumptions. |

When information received after the reporting date is not reflected in an entity's estimate of expected credit losses, the entity considers whether additional disclosures are required to prevent the financial statements from being misleading. This includes consideration of whether it is necessary to disclose pro forma financial data or present pro forma financial statements. [855-10-50-2 – 50-3]

## **Question 21.2.20** Must an entity incorporate economic data available through the reporting date in its estimate of credit losses?

**Interpretive response:** Yes. Subtopic 326-20 requires that the estimates be made as of the reporting date. [326-20-30-1]

Some entities may develop or obtain forecasts of future economic conditions earlier than the reporting date to meet tight financial reporting deadlines – e.g. forecasts may be developed or obtained in November for the purpose of December year-end financial reporting. To estimate credit losses, we believe these entities need to consider any new information they may obtain up to and including the reporting date.

## **Question 21.2.30** Must an entity incorporate economic data available after the reporting date (but before the financial statements are issued) in its estimate of credit losses?

**Interpretive response:** Economic data relates to forecasting assumptions, rather than representing loan-specific information. As a result, whether an entity should incorporate economic data available after the reporting date depends on whether that information indicates a weakness or deficiency in the entity's estimation process and on whether it is received before (or after) the entity has

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

completed its process for estimating expected credit losses (see Question 21.2.10). [2018 AICPA Conf]

This is the case even if the information includes economic data about a period that includes the reporting date. For example, management's adjustments to historical loss information for current conditions and reasonable and supportable forecasts may be based on estimates of unemployment published by the government. After the reporting date, the government may announce estimates of unemployment – or revise estimates that were made in prior announcements – for periods that include the reporting date. The following table summarizes whether an entity should adjust its estimate of expected credit losses. [2018 AICPA Conf]

| Timing of announcement | Information indicates a weakness or deficiency in the entity's estimation process | Information does not indicate a weakness or deficiency in the entity's estimation process |
|---|---|---|
| **Before the entity has completed its estimation process** | The entity should adjust its estimate of expected credit losses as of the reporting date.<br>Additionally, we believe the entity should evaluate the impact of the weakness or deficiency (see footnote 1 to the flowchart in Question 21.2.10). | The entity is permitted (but not required) to adjust its estimate of expected credit losses as of the reporting date.<br>If the entity does not adjust its estimate, it should consider whether disclosures are necessary to prevent the financial statements from being misleading. |
| **After the entity has completed its estimation process** | The entity should adjust its estimate of expected credit losses as of the reporting date.<br>Additionally, we believe the entity should evaluate the impact of the weakness or deficiency (see footnote 1 to the flowchart in Question 21.2.10). | The entity should not adjust its estimate of expected credit losses as of the reporting date (it is a nonrecognized subsequent event).<br>The entity should consider whether disclosures are necessary to prevent the financial statements from being misleading. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 23. Presentation

## Detailed contents

**23.1 How the standard works**

**23.2 Financial instruments in the scope of Subtopic 326-20**

23.2.10 Balance sheet presentation

23.2.20 Income statement presentation

**Questions**

**Question 23.2.05** May accrued interest receivable be presented separately from the associated financial asset?

**Question 23.2.07** How is the allowance for credit losses for financial assets measured at amortized cost presented?

**23.3 AFS debt securities**

23.3.10 Overview

**Question**

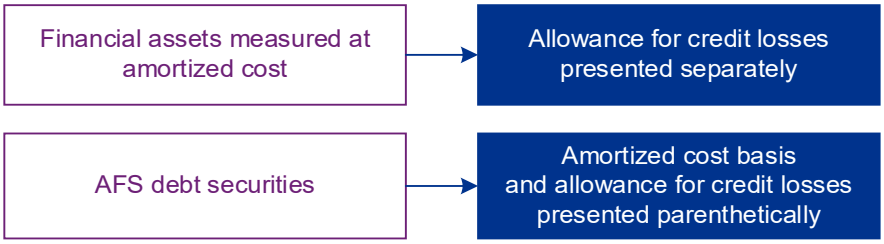
**Question 23.3.10** May accrued interest receivable be presented separately from the associated AFS debt security?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 23.1 How the standard works

Topic 326 has different presentation requirements for:

- financial assets measured at amortized cost in the scope of the expected credit loss guidance (Subtopic 326-20); and
- AFS debt securities (Subtopic 326-30).




The amortized cost of a financial asset (including that of a debt security) includes the related accrued interest receivable. Topic 326 provides alternatives for how information related to accrued interest receivable is presented in the balance sheet and the income statement.

- **Balance sheet**: An entity may present accrued interest receivable and the related allowance for credit losses separately from the associated financial assets or net investments in leases.
- **Income statement:** An entity may present the writeoff of accrued interest receivable by reversing interest income, recognizing credit loss expense, or both.

The elections related to presentation of accrued interest receivable are available for AFS debt securities only if certain conditions are met.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 23.2 Financial instruments in the scope of Subtopic 326-20

### Excerpt from ASC 326-20

• > Off-Balance-Sheet Credit Exposures

**30-11** In estimating expected credit losses for off-balance-sheet credit exposures, an entity shall estimate expected credit losses on the basis of the guidance in this Subtopic over the contractual period in which the entity is exposed to credit risk via a present contractual obligation to extend credit, unless that obligation is unconditionally cancellable by the issuer. At the reporting date, an entity shall record a liability for credit losses on off-balance-sheet credit exposures within the scope of this Subtopic. …

**General**

**45-1** For **financial assets** measured at amortized cost within the scope of this Subtopic, an entity shall separately present on the statement of financial position, the allowance for credit losses that is deducted from the asset's **amortized cost basis**.

**45-2** For off-balance-sheet credit exposures within the scope of this Subtopic, an entity shall present the estimate of expected credit losses on the statement of financial position as a liability. The liability for credit losses for off-balance-sheet financial instruments shall be reduced in the period in which the off-balance-sheet financial instruments expire, result in the recognition of a financial asset, or are otherwise settled. An estimate of expected credit losses on a financial instrument with off-balance-sheet risk shall be recorded separate from the allowance for credit losses related to a recognized financial instrument.

**45-3** When a discounted cash flow approach is used to estimate expected credit losses, the change in present value from one reporting period to the next may result not only from the passage of time but also from changes in estimates of the timing or amount of expected future cash flows. An entity that measures credit losses based on a discounted cash flow approach is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense). Alternatively, an entity may report the change in present value attributable to the passage of time as interest income. See paragraph 326-20-50-12 for a disclosure requirement applicable to entities that choose the latter alternative and report changes in present value attributable to the passage of time as interest income.

**45-4** The **fair value** of the collateral of a collateral-dependent financial asset may change from one reporting period to the next. Changes in the fair value of the collateral shall be reported as credit loss expense or a reversal of credit loss expense when the guidance in paragraphs 326-20-35-4 through 35-6 is applied.

**45-5** An entity may make an accounting policy election, at the class of financing receivable or major security-type level, to present separately on the statement of financial position or within another statement of financial position

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

line item the accrued interest receivable balance, net of the allowance for credit losses (if any). An entity that presents the accrued interest receivable balance, net of the allowance for credit losses (if any), within another statement of financial position line item shall apply the disclosure requirements in paragraph 326-20-50-3A.

## 23.2.10 Balance sheet presentation

The following amounts are presented on the balance sheet separately:

- the allowance for credit losses related to assets measured at amortized cost – presented separately from the assets' amortized cost basis. [326-20-45-1]
- the liability for off-balance sheet credit exposures – presented separately from the allowance for credit losses. This liability is reduced when the off-balance sheet credit exposure expires, results in the recognition of a financial asset or is otherwise settled. The liability is increased or reduced if an entity's expectation of the likelihood or magnitude of expected credit losses changes. For off-balance sheet credit exposure see chapter 13. [326-20-45-2]

### **Question 23.2.05** May accrued interest receivable be presented separately from the associated financial asset?

**Interpretive response**: Yes. An entity may make an accounting policy election to present accrued interest receivable, net of the related allowance for credit losses (if any), separately from the associated financial assets and/or net investments in leases.

In this situation, the net amount may be presented: [326-20-45-5]

- as a separate line item on the balance sheet; or
- in a line item together with other balances, with note disclosure of the amounts and the balance sheet line item in which they are included (see section 24.2.100).

The FASB created this election to provide relief from Subtopic 326-20's presentation requirements because stakeholders raised concerns about issues associated with accrued interest, including the operational burden and cost of tracking accrued interest at the individual loan level. [ASU 2019-04.BC12, BC14]

See also section 4.2.20 for guidance related to measuring the allowance for credit losses for accrued interest receivables.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 23.2.07** How is the allowance for credit losses for financial assets measured at amortized cost presented?

**Interpretive response:** On the balance sheet, an entity is required to separately present the allowance for credit losses for financial assets measured at amortized cost. We believe an entity may present the allowance either: [326-20-45-1]

- parenthetically; or
- separately as a reduction of the amortized cost basis.

We believe an entity may use different approaches for different types of financial assets measured at amortized cost.

## 23.2.20 Income statement presentation

Credit losses are presented as credit loss expense for loans and receivables and HTM debt securities. However, Topic 326 does not specify whether the credit loss expense for off-balance sheet credit exposure must be presented in the same line item as credit loss expense for other assets in its scope. As a result, there may be diversity in practice. Further, certain elections may affect presentation of credit losses as explained below.

### *Election regarding discounted cash flow method*

If an entity uses a discounted cash flow method to estimate expected credit losses, it may present: [326-20-45-3, 50-12]

- the entire change in present value – including the change related to the passage of time – as credit loss expense or reversal of credit loss expense; or
- the change in present value related to the passage of time as interest income. If this alternative is elected, the entity is required to disclose the amount of interest income that represents the change in present value attributable to the passage of time.

### *Collateral-dependent financial assets*

An entity estimates expected credit losses based on the fair value of collateral when (1) foreclosure is probable or (2) it applies the practical expedient for collateral-dependent financial assets or financial assets that meet the collateral maintenance provision requirements (see chapter 10).

In these instances, when changes in the fair value of collateral result in changes in expected credit losses, those changes in expected credit losses are presented in credit loss expense or reversal of credit loss expense. [326-20-35-4 – 35-6, 326-20-45-4]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### *Election regarding accrued interest receivable*

An entity may elect to write off accrued interest receivable through reversing interest income, recognizing credit loss expense, or both. This election is made for each class of financing receivable or major security type (see Question 4.2.50). [326-20-35-8A]

## 23.3 AFS debt securities

### 23.3.10 Overview

#### Excerpt from ASC 326-30

**45-1** An entity shall present **available-for-sale debt securities** on the statement of financial position at **fair value**. In addition, an entity shall present parenthetically the **amortized cost basis** and the allowance for credit losses. If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the fair value and the amortized cost basis of the available-for-sale debt security, an entity may present separately on the statement of financial position or within another statement of financial position line item the accrued interest receivable balance, net of the allowance for credit losses (if any). An entity that presents the accrued interest receivable balance, net of the allowance for credit losses (if any), within another statement of financial position line item shall apply the disclosure requirements in paragraph 326-30-50-3A.

**45-2** An entity shall separately present, in the financial statement in which the components of accumulated other comprehensive income are reported, amounts reported therein related to available-for-sale debt securities for which an allowance for credit losses has been recorded.

**45-3** When an entity applies the guidance in paragraph 326-30-35-7, the change in present value of cash flows expected to be collected from one reporting period to the next may result not only from the passage of time but also from changes in estimates of the timing or amount of expected future cash flows. An entity is permitted to report the entire change in present value as a credit loss expense (or a reversal of credit loss expense). Alternatively, an entity may report the change in present value attributable to the passage of time as interest income. See paragraph 326-30-50-8 for a disclosure requirement applicable to creditors that choose the latter alternative and report changes in present value attributable to the passage of time as interest income.

#### Excerpt from ASC 320-10

> Other Comprehensive Income

**45-9** Subsequent increases or decreases in the fair value of available-for-sale securities that do not result in recognition or reversal of an allowance for credit loss or write-down in accordance with Subtopic 326-30 on measuring credit

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

losses on available-for-sale debt securities shall be included in other comprehensive income pursuant to paragraphs 320-10-35-1(b) and 320-10-45-8.

AFS debt securities are presented on the balance sheet at fair value with the amortized cost basis and allowance for credit losses presented parenthetically. [326-30-45-1]

Changes in fair value that do not result in recognition or reversal of an allowance for credit losses or a writedown of the security are included in other comprehensive income. In the financial statement in which the components of accumulated other comprehensive income are reported, an entity separately presents any amounts related to AFS debt securities for which an allowance for credit losses is reported. [320-10-45-9, 326-30-45-2]

Under Subtopic 326-30, an entity is required to use a discounted cash flow method when estimating credit losses for AFS debt securities, with the credit loss limited to the difference between the amortized cost basis and fair value of the debt security.

Credit losses are presented as credit loss expense. However, certain elections may affect presentation of credit losses as explained below.

### *Election regarding discounted cash flow method*

An entity may present: [326-30-45-3, 50-8]

- the entire change in present value, including the change related to the passage of time, as credit loss expense (or reversal of credit loss expense); or
- the change in present value related to the passage of time as interest income. If this alternative is elected, the entity is required to disclose the amount of interest income that represents the change in present value attributable to the passage of time.

### *Election regarding accrued interest receivable*

An entity that excludes accrued interest receivable from both the fair value and amortized cost basis for purposes of identifying and measuring impairment may elect to write off accrued interest receivable through reversing interest income, recognizing credit loss expense, or both. This election is made for each major security type (see Questions 19.6.30 and 4.2.50). [326-30-35-13A]

## **Question 23.3.10** May accrued interest receivable be presented separately from the associated AFS debt security?

**Interpretive response**: Yes, provided the entity excludes accrued interest receivable from both the fair value and amortized cost basis of debt securities for purposes of identifying and measuring impairment. In this situation, the entity may elect to present accrued interest receivable, net of the related

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

allowance for credit losses (if any), separately from the associated AFS debt security.

When an entity elects to separately present accrued interest receivable, it may present the net amount: [326-20-45-1]

- as a separate line item on the balance sheet; or
- in a line item together with other balances, with note disclosure of the amount of the accrued interest receivable and the balance sheet line item in which it is included (see section 24.3.60).

See also section 19.4.30 for guidance related to measuring the allowance for credit losses for accrued interest receivables.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 24. Disclosures

## Detailed contents

New item added in this edition: **
Item significantly updated in this edition: #

**24.1 How the standard works**

**24.2 Financial instruments measured at amortized cost (Subtopic 326-20)**

24.2.10 Overview

24.2.20 Credit quality information

24.2.30 Allowance for credit losses

24.2.40 Roll-forward of the allowance for credit losses

24.2.50 Past-due status

24.2.60 Nonaccrual status

24.2.70 PCD financial assets

24.2.80 Collateral-dependent financial assets

24.2.85 Simplifications for current accounts receivable and contract assets**

24.2.90 Off-balance sheet credit exposures

24.2.100 Accrued interest receivable

**Questions**

**Question 24.2.10** How are disclosures disaggregated for financial instruments measured at amortized cost?

**Question 24.2.20** Must accrued interest receivable be included in disclosure of the amortized cost of financing receivables and HTM securities?

**Question 24.2.30** What are credit quality indicators and how are the appropriate ones identified?

**Question 24.2.40** What disclosures are required about credit quality information?

**Question 24.2.50** What 'vintage year' information do PBEs include when disclosing the amortized cost basis within each credit quality indicator?

**Question 24.2.60** What is the purpose of vintage-year disclosures and why do only PBEs need to provide them?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Question 24.2.70** How are line-of-credit arrangements that have converted to term loans disclosed in the vintage disclosures?

**Question 24.2.80** If a PBE elects to maintain pools of loans previously accounted for under Subtopic 310-30, how are they included in the vintage disclosures?

**Question 24.2.90** Must an entity provide credit quality disclosures for contract assets?

**Question 24.2.100** What disclosures are required about the allowance for credit losses?

**Question 24.2.110** What incremental disclosures are required when expected credit losses are estimated using a discounted cash flow method?

**Question 24.2.120** What information does an entity disclose about the reversion method?

**Question 24.2.130** Does an entity disclose whether single or multiple economic scenarios are used to develop its economic forecast?

**Question 24.2.140** Does an entity disclose what the reasonable and supportable forecast period is?

**Question 24.2.150** What disclosures are required about the roll-forward of the allowance for credit losses?#

**Question 24.2.160** What disclosures are required about past-due status?

**Question 24.2.170** What quantitative disclosures are required about nonaccrual status?

**Question 24.2.180** What disclosures are required about an entity's nonaccrual status policies?

**Question 24.2.190** What disclosures are required for PCD assets?

**Question 24.2.200** What disclosures are required for collateral-dependent financial assets?

**Question 24.2.205** What disclosures are required when an entity elects the simplified guidance for current accounts receivable and contract assets?

**Question 24.2.210** What disclosures are required for off-balance sheet credit exposures?

**Question 24.2.220** What disclosures are required about an entity's elections related to accrued interest receivable?

## Examples

**Example 24.2.10** Disclosing credit quality of HTM debt securities

**Example 24.2.20** Disclosing past-due status of HTM debt securities

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.3 AFS debt securities (Subtopic 326-30)

24.3.10 Overview

24.3.20 AFS debt securities in unrealized loss positions without an allowance for credit losses

24.3.30 Allowance for credit losses

24.3.40 Roll-forward of the allowance for credit losses

24.3.50 PCD financial assets

24.3.60 Accrued interest receivable

### Questions

**Question 24.3.10** How are disclosures for AFS debt securities disaggregated?

**Question 24.3.20** Must accrued interest receivable be included in disclosures of the amortized cost of AFS debt securities?

**Question 24.3.30** What are the quantitative disclosures required for AFS debt securities in an unrealized loss position without an allowance for credit losses?

**Question 24.3.40** What are the narrative disclosures required for AFS debt securities in an unrealized loss position without an allowance for credit losses?

**Question 24.3.50** Do the disclosures for an AFS debt security in an unrealized loss position apply if an allowance for credit losses has been recognized for a portion of the loss?

**Question 24.3.60** What disclosures are required about the allowance for credit losses?

**Question 24.3.70** What incremental disclosures are required for the change in present value of cash flows expected to be collected?

**Question 24.3.80** What disclosures are required about the roll-forward of the allowance for credit losses?

**Question 24.3.90** What disclosures are required for PCD financial assets classified as AFS debt securities?

**Question 24.3.100** What disclosures are required about an entity's elections related to accrued interest receivable?

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.1 How the standard works

Topic 326 requires disclosure of both qualitative and quantitative information about an entity's financial assets and the allowance for credit losses. The objective of these disclosures is to help financial statement users understand:

- the credit risk inherent in an entity's portfolio of financial assets;
- how management monitors the portfolio's credit quality;
- management's estimate of expected credit losses; and
- changes in the estimate of expected credit losses that have taken place during the period.

The same overall objectives apply to disclosures for financial instruments measured at amortized cost (Section 326-20-50) and AFS debt securities (Section 326-30-50), although the sections have different disclosure topics. The disclosure topics include the following.

| Disclosure topics for financial instruments measured at amortized cost (Subtopic 326-20) | Disclosure topics for AFS debt securities (Subtopic 326-30) |
|---|---|
| • Credit quality information (section 24.2.20)<br>• Allowance for credit losses (section 24.2.30)<br>• Roll-forward of the allowance (section 24.2.40)<br>• Past-due status (section 24.2.50)<br>• Nonaccrual status (section 24.2.60)<br>• PCD financial assets (section 24.2.70)<br>• Collateral-dependent financial assets (section 24.2.80)<br>• Off-balance sheet credit exposures (section 24.2.90)<br>• Accrued interest receivable (section 24.2.100) | • AFS debt securities in unrealized loss positions (for which no allowance for credit losses has been recorded (section 24.3.20)<br>• Allowance for credit losses (section 24.3.30)<br>• Roll-forward of the allowance (section 24.3.40)<br>• PCD financial assets (section 24.3.50)<br>• Accrued interest receivable (section 24.3.60) |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 24.2 Financial instruments measured at amortized cost (Subtopic 326-20)

## 24.2.10 Overview

### Excerpt from ASC 326-20

**50-1** For instruments within the scope of this Subtopic, this Section provides the following disclosure guidance on credit risk and the measurement of expected credit losses:

a. Credit quality information
b. Allowance for credit losses
c. Past-due status
d. Nonaccrual status
e. **Purchased financial assets with credit deterioration**
f. Collateral-dependent **financial assets**
g. Off-balance-sheet credit exposures.

**50-2** The disclosure guidance in this Section should enable a user of the financial statements to understand the following:

a. The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio
b. Management's estimate of expected credit losses
c. Changes in the estimate of expected credit losses that have taken place during the period.

**50-3** For **financing receivables**, the disclosure guidance in this Subtopic requires an entity to provide information by either **portfolio segment** or **class of financing receivable**. Net investment in leases are within the scope of this Subtopic, and the disclosure requirements for financing receivables shall be applied to net investment in leases (including the unguaranteed residual asset). For held-to-maturity **debt securities**, the disclosure guidance in this Subtopic requires an entity to provide information by major security type. Paragraphs 326-20-55-10 through 55-14 provide implementation guidance about the terms *portfolio segment* and class of *financing receivable*. When disclosing information, an entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements in this Section. An entity must strike a balance between not obscuring important information as a result of too much aggregation and not overburdening financial statements with excessive detail that may not assist a financial statement user in understanding the entity's financial assets and allowance for credit losses. For example, an entity should not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of financial assets and associated risks.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

• > Disclosure – Application of the Term *Portfolio Segment*

**55-10** This implementation guidance addresses the meaning of the term *portfolio segment*. All of the following are examples of portfolio segments:

a. Type of **financing receivable**
b. Industry sector of the borrower
c. Risk rating.

• > Disclosure – Application of the Term *Class of Financing Receivable*

**55-11** This implementation guidance addresses application of the term **class of financing receivable**. An entity should base its principal determination of class of financing receivable by disaggregating to the level that the entity uses when assessing and monitoring the risk and performance of the portfolio for various types of financing receivables. In its assessment, the entity should consider the risk characteristics of the financing receivables.

**55-12** In determining the appropriate level of its internal reporting to use as a basis for disclosure, an entity should consider the level of detail needed by a user to understand the risks inherent in the entity's financing receivables. An entity could further disaggregate its financing receivables portfolio by considering numerous factors. Examples of factors that the entity should consider include any of the following:

a. Categorization of borrowers, such as any of the following:
    1. Commercial loan borrowers
    2. Consumer loan borrowers
    3. **Related party** borrowers.
b. Type of financing receivable, such as any of the following:
    1. Mortgage loans
    2. Credit card loans
    3. Interest-only loans
    4. Finance leases.
c. Industry sector, such as either of the following:
    1. Real estate
    2. Mining.
d. Type of collateral, such as any of the following:
    1. Residential property
    2. Commercial property
    3. Government-guaranteed collateral
    4. Uncollateralized (unsecured) financing receivables.
e. Geographic distribution, including both of the following:
    1. Domestic
    2. International.

**55-13** An entity also may consider factors related to concentrations of credit risk as discussed in Section 825-10-55.

**55-14** Classes of financing receivables generally are a disaggregation of a **portfolio segment**. For determining the appropriate classes of financing receivables that are related to a portfolio segment, the portfolio segment is the starting point with further disaggregation in accordance with the guidance in paragraphs 326-20-55-11 through 55-13. The determination of class for financing receivables that are not related to a portfolio segment (because there

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

is no associated allowance) also should be based on the guidance in those paragraphs.

Financial statement disclosures about financial instruments measured at amortized cost are intended to provide information that is useful in analyzing an entity's exposures to credit risk and management's estimate of expected credit losses. To accomplish this, Subtopic 326-20 contains specific disclosure topics, each of which is detailed in a separate subsection below.

Each of these specific disclosure topics contains one or more objectives that are based on the overall disclosure objectives for Subtopic 326-20. The overall objectives are to provide disclosures that help financial statement users understand the following: [326-20-50-2, ASU 2016-13.BC106]

- credit risk inherent in a portfolio and how management monitors credit quality of the portfolio;
- management's estimate of expected credit losses; and
- changes in the estimate of expected credit losses that have taken place during the period.

The disclosure requirements in Subtopic 326-20 apply to instruments in its scope of (see chapter 2), except as otherwise specified. Disclosure relief is available for accrued interest receivable included in the amortized cost of certain financial assets (see Question 24.2.20).

## **Question 24.2.10** How are disclosures disaggregated for financial instruments measured at amortized cost?

**Interpretive response**: How disclosures are disaggregated depends on the type of financial asset.

| Financing receivables and net investment in leases | HTM debt securities |
|---|---|
| Information provided by either portfolio segment or class of financing receivable, depending on the requirements for the specific disclosure topic. [326-20-50-3] | Information provided by major security type. [326-20-50-3] |
| A portfolio segment is the level at which an entity develops and documents a systematic methodology to determine its allowance for credit losses. [326-20 Glossary]<br>Examples of portfolio segments include: [326-20-55-10]<br>• type of financing receivable;<br>• industry sector of the borrower;<br>• risk rating. | Major security types are based on the nature and risks of the security. In determining whether disclosure for a particular security type is necessary and whether it is necessary to further separate a particular security type into greater detail, an entity considers all of the following: [320-10-50-1B]<br>• shared activity or business sector;<br>• vintage;<br>• geographic concentration;<br>• credit quality;<br>• economic characteristics. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Financing receivables and net investment in leases | HTM debt securities |
|---|---|
| A class of financing receivable is a grouping based on both the risk characteristics of the financing receivable and the entity's method for monitoring and assessing credit risk. [326-20 Glossary]<br>It is generally a disaggregation of a portfolio segment and may include consideration of factors such as: [326-20-55-11 – 55-14]<br>• categorization of borrowers – e.g. commercial or consumer borrowers;<br>• type of financing receivable – e.g. mortgage loan, credit card loan, interest-only loan or finance lease;<br>• industry sector – e.g. real estate, mining;<br>• collateral type – e.g. residential or commercial property, government-guaranteed collateral, uncollateralized (unsecured);<br>• geographic distribution – e.g. domestic, international;<br>• concentrations of credit risk. | |

Judgment is necessary to determine the appropriate level of detail to disclose based on an entity's particular facts and circumstances. However, there are two competing concerns involved in determining the appropriate level of aggregation or detail. [326-20-50-3]

- On one hand, the information should not be aggregated to such a degree that important information is obscured.
- On the other hand, the information should not be disaggregated to such a degree that the financial statement users are overburdened with excessive detail that is not decision useful.

## **Question 24.2.20** Must accrued interest receivable be included in disclosure of the amortized cost of financing receivables and HTM securities?

**Interpretive response:** No. Due to stakeholder concerns, the FASB provided relief for the measurement (see section 4.2.20), presentation (see Question 23.2.05) and disclosure requirements for accrued interest receivable balances.

Under the disclosure relief, a practical expedient permits an entity to exclude accrued interest receivable included in the amortized cost of financing receivables and HTM securities from the disclosure requirements in paragraphs 326-20-50-4 to 50-22 (see sections 24.2.20 to 24.2.90). If an entity elects the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

practical expedient, it discloses the total amount of accrued interest excluded from the disclosed amortized cost basis. [326-20-50-3B]

See section 24.2.100 for further information about disclosures related to accrued interest receivable.

## 24.2.20 Credit quality information

### Excerpt from ASC 326-20

**20 Glossary**

**Credit Quality Indicator**

A statistic about the credit quality of financing receivables.

> Credit Quality Information

**50-4** An entity shall provide information that enables a financial statement user to do both of the following:

a. Understand how management monitors the credit quality of its **financial assets**
b. Assess the quantitative and qualitative risks arising from the credit quality of its financial assets.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-4** For interim and annual reporting periods, an~~An~~ entity shall provide information that enables a financial statement user to do both of the following: …

**50-5** To meet the objectives in paragraph 326-20-50-4, an entity shall provide quantitative and qualitative information by **class of financing receivable** and major security type about the credit quality of financial assets within the scope of this Subtopic (excluding off-balance-sheet credit exposures and repurchase agreements and securities lending agreements within the scope of Topic 860), including all of the following:

a. A description of the **credit quality indicator(s)**
b. The **amortized cost basis**, by credit quality indicator
c. For each credit quality indicator, the date or range of dates in which the information was last updated for that credit quality indicator.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-5** To meet the objectives in paragraph 326-20-50-4, an entity shall provide quantitative and qualitative information in interim and annual reporting periods by **class of financing receivable** and major security type about the credit quality of financial assets within the scope of this

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

Subtopic (excluding off-balance-sheet credit exposures and repurchase agreements and securities lending agreements within the scope of Topic 860), including all of the following: …

**50-6** When disclosing credit quality indicators of **financing receivables** and net investment in leases (except for **reinsurance recoverables** and funded or unfunded amounts of **line-of-credit arrangements**, such as credit cards), a **public business entity** shall present the **amortized cost basis** within each credit quality indicator by year of origination (that is, vintage year). For purchased financing receivables and net investment in leases, an entity shall use the initial date of issuance to determine the year of origination, not the date of acquisition. For origination years before the fifth annual period, a public business entity may present the amortized cost basis of financing receivables and net investments in leases in the aggregate. For interim-period disclosures, the current year-to-date originations in the current reporting period are considered to be the current-period originations. A public business entity shall present the gross writeoffs recorded in the current period, on a current year-to-date basis, for financing receivables and net investments in leases by origination year. For origination years before the fifth annual period, a public business entity may present the gross writeoffs in the current period for financing receivables and net investments in leases in the aggregate. The requirement to present the amortized cost basis within each credit quality indicator by year of origination is not required for an entity that is not a public business entity.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-6** When disclosing credit quality indicators of **financing receivables** and net investment in leases (except for **reinsurance recoverables** and funded or unfunded amounts of **line-of-credit arrangements**, such as credit cards), a **public business entity** shall present the **amortized cost basis** within each credit quality indicator by year of origination (that is, vintage year) in interim and annual reporting periods. …

**50-6A** For the purpose of the disclosure requirement in paragraph 326-20-50-6, a public business entity shall present the amortized cost basis of line-of-credit arrangements that are converted to term loans in a separate column (see Example 15 in paragraph 326-20-55-79). A public business entity shall disclose in each reporting period, by class of financing receivable, the amount of line-of-credit arrangements that are converted to term loans in each reporting period and the total of these financing receivables that were written off in the current reporting period in accordance with paragraph 326-20-50-6.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-6A** … A public business entity shall disclose in each interim and annual reporting period, by class of financing receivable, the amount of line-of-credit arrangements that are converted to term loans in each reporting period and the total of these financing receivables that were

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

written off in the current reporting period in accordance with paragraph 326-20-50-6.

**50-7** Except as provided in paragraph 326-20-50-6A, a public business entity shall use the guidance in paragraphs 310-20-35-9 through 35-11 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. A public business entity shall use the guidance in paragraphs 842-10-25-8 through 25-9 when determining whether a lease modification should be presented as a current-period origination.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-7** Except as provided in paragraph 326-20-50-6A, for interim and annual reporting periods, a public business entity shall use the guidance in paragraphs 310-20-35-9 through 35-11 when determining whether a modification, extension, or renewal of a financing receivable should be presented as a current-period origination. …

**50-8** If an entity discloses internal risk ratings, then the entity shall provide qualitative information on how those internal risk ratings relate to the likelihood of loss.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-8** If an entity discloses internal risk ratings, then the entity shall provide qualitative information in interim and annual reporting periods on how those internal risk ratings relate to the likelihood of loss.

**50-9** The requirements to disclose credit quality indicators in paragraphs 326-20-50-4 through 50-5 do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-9** The requirements to disclose credit quality indicators in paragraphs 326-20-50-4 through 50-5 for interim and annual reporting periods do not apply to receivables measured at the lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

> Disclosure — Application of the Term Credit Quality Indicator

**55-15** This implementation guidance addresses application of the term credit quality indicator. Examples of credit quality indicators include all of the following:

a. Consumer credit risk scores
b. Credit-rating-agency ratings
c. An entity's internal credit risk grades
d. Debt-to-value ratios
e. Collateral
f. Collection experience
g. Other internal metrics.

**55-16** An entity should use judgment in determining the appropriate credit quality indicator for each **class of financing receivable** and major security type. As of the balance sheet date, the entity should use the most current information it has obtained for each credit quality indicator.

The disclosures about credit quality information are designed to help financial statement users do both of the following: [326-20-50-4]

- understand how management monitors the credit quality of its financial assets; and
- assess the quantitative and qualitative risks arising from the credit quality of its financial assets.

The disclosure requirements focus on credit quality indicators and the amortized cost basis of financial assets. Although all entities are required to provide disclosures about credit quality information, PBEs are required to present additional 'vintage year' information in the disclosures of the amortized cost basis within each credit quality indicator (see Questions 24.2.40 to 24.2.80).

## **Question 24.2.30** What are credit quality indicators and how are the appropriate ones identified?

**Interpretive response:** Credit quality indicators are statistics about the credit quality of financing receivables. [326-20 Glossary]

Examples include: [326-20-55-15]

- consumer credit risk scores;
- credit-rating-agency ratings;
- an entity's internal credit risk grades;
- debt-to-value ratios;
- collateral;
- collection experience; and
- other internal metrics.

An entity applies judgment in determining the appropriate credit quality indicator for each class of financing receivable and major security type. As of the reporting date, the entity uses the most current information it has obtained for each credit quality indicator. [326-20-55-16]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 24.2.40** What disclosures are required about credit quality information?

**Interpretive response:** An entity discloses quantitative and qualitative information about credit quality, including the following, disaggregated by class of financing receivable and major security type: [326-20-50-5]

- a description of the credit quality indicator(s);
- the amortized cost basis, by credit quality indicator; and
- for each credit quality indicator, the date or range of dates in which the information was last updated.

If an entity discloses internal risk ratings, it provides qualitative information on how those internal risk ratings relate to the likelihood of loss. [326-20-50-8]

These disclosures apply to financial assets in the scope of Subtopic 326-20, except for: [326-20-50-5]

- off-balance sheet credit exposures; and
- repurchase agreements and securities lending agreements in the scope of Topic 860.

However, they do not apply to: [326-20-50-9]

- receivables measured at the lower of amortized cost basis or fair value; and
- trade receivables due in one year or less (except for credit card receivables) that result from revenue transactions in the scope of Topic 606 (revenue from contracts with customers) or legacy Topic 605 (revenue recognition).

## **Question 24.2.50** What 'vintage year' information do PBEs include when disclosing the amortized cost basis within each credit quality indicator?

**Interpretive response:**

***Applicability***

Additional presentation guidance applies to a PBE's disclosures about amortized cost basis within each credit quality indicator. That additional guidance applies only to financing receivables and net investments in leases, except for: [326-20-50-6]

- reinsurance receivables; and
- funded or unfunded amounts of line-of-credit arrangements, such as credit cards.

***Requirements***

A PBE presents the amortized cost basis within each credit quality indicator and gross writeoffs recorded in the current year (on a current year-to-date basis) by year of origination – i.e. by vintage year. A PBE provides, by class of financing receivable, separate columns for (1) revolving loans and (2) revolving loans that have been converted to term loans. [326-20-50-6 – 50-6A]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Related guidance for disclosing credit quality indicators by origination year |
|---|
| **Guidance on year of origination (vintage year)** [326-20-50-6] |
| For purchased financing receivables and net investments in leases, a PBE uses the initial date of issuance to determine the year of origination, not the date of acquisition. |
| For origination years before the fifth annual period, a PBE may present the amortized cost basis and gross writeoffs of financing receivables and net investments in leases in the aggregate. |
| For interim period disclosures, the current year-to-date originations in the current reporting period are considered to be the current period originations. |
| **Guidance on line-of-credit conversions** [326-20-50-6A] |
| A PBE presents the amortized cost basis of line-of-credit arrangements that were converted to term loans in a separate column within the entity's vintage disclosures. See FASB Example 15 in paragraph 326-20-55-79 (reproduced below); see also Question 24.2.70. |
| A PBE discloses in each reporting period, by class of financing receivable, the amount of line-of-credit arrangements that were converted to term loans in each reporting period and the total of these financing receivables that were written off in the current reporting period; see also Question 24.2.70. |
| **Guidance on current period originations** [326-20-50-7] |
| Except for line-of-credit arrangements that have been converted to term loans (see Question 24.2.70), a PBE uses the guidance in paragraphs 310-20-35-9 to 35-11 (receivables – nonrefundable fees and other costs – subsequent measurement – loan refinancing or restructuring) when determining whether a modification, extension or renewal of a financing receivable should be presented as a current period origination. |
| An entity uses the guidance in paragraphs 842-10-25-8 to 25-9 (leases overall – recognition – lease modifications) when determining whether a lease modification should be presented as a current period origination. |

## **Question 24.2.60** What is the purpose of vintage-year disclosures and why do only PBEs need to provide them?

**Interpretive response:** The FASB deemed the vintage-year information necessary so that financial statement users can understand the credit quality trends within a portfolio from period to period. Users can also combine the vintage-year information with information disclosed in other areas in the financial statements and assumptions from public sources to derive their own roll-forward of the balances and related allowance for credit losses for each origination year. [ASU 2016-13.BC114]

The FASB believes this provides useful information because it helps users develop estimates of: [ASU 2016-13.BC114]

- originations by period for each class of financing receivable;
- the initially expected credit losses and subsequent changes to the estimate; and

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- the current-period provision attributable to originations and changes in expected credit losses on previously originated loans.

Only PBEs are required to make these disclosures because the FASB believes investors in private companies can generally obtain the information they need from management. [ASU 2016-13.BC114]

## **Question 24.2.70** How are line-of-credit arrangements that have converted to term loans disclosed in the vintage disclosures?

**Interpretive response:** There are two disclosure requirements in the vintage disclosures for line-of-credit arrangements that have been converted to term loans. [326-20-50-6A]

- The amortized cost basis of line-of-credit arrangements that were converted to term loans is presented in a separate column. Therefore, an entity presents all currently outstanding term loans that were funded through a drawdown of line-of-credit arrangements in a separate column. See FASB Example 15 in paragraph 326-20-55-79 (reproduced below).
- The amount of line-of-credit arrangements that were converted to term loans in each reporting period is disclosed. We believe an entity may present this amount as a footnote to the amounts disclosed in the first requirement. We further believe an entity may develop other alternatives to present this amount.

## **Question 24.2.80** If a PBE elects to maintain pools of loans previously accounted for under Subtopic 310-30, how are they included in the vintage disclosures?

**Interpretive response:** We believe either of the following approaches, consistently applied, is acceptable.

- Include such loans in the vintage disclosure table based on the vintage of each of the underlying loans.
- Exclude such loans from the vintage disclosure table. Instead, place a note after the table indicating that the table does not include the loans previously accounted for under Subtopic 310-30 that the entity elected to maintain as pools after adoption (see section 12.6). This note should also include the vintage years of assets in the pools, the aggregate amortized cost basis and information about the credit quality of the assets in the pools.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 24.2.90** Must an entity provide credit quality disclosures for contract assets?

### Excerpt from ASC 606-10

**45-3** If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a **contract asset**, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for credit losses in accordance with Subtopic 326-20 on financial instruments measured at amortized cost. A credit loss of a contract asset shall be measured, presented, and disclosed in accordance with Subtopic 326-20 (see also paragraph 606-10-50-4(b)).

**45-4** A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future. An entity shall account for a receivable in accordance with Topic 310 and Subtopic 326-20. Upon initial recognition of a receivable from a contract with a customer, any difference between the measurement of the receivable in accordance with Subtopic 326-20 and the corresponding amount of **revenue** recognized shall be presented as a credit loss expense.

**20 Glossary**

**Contract Asset**

An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance).

**Interpretive response:** Yes. Credit losses of contracts assets are disclosed under Subtopic 326-20. Therefore, an entity must provide quantitative and qualitative information about the credit quality of contract assets. [606-10-45-3]

However, we believe contract assets are not subject to the credit quality disclosures by origination year (vintage disclosures) because such disclosures only apply to financing receivables and net investments in leases. A contract asset does not meet the definition of a financing receivable because the right to collect payment is conditioned on something other than the passage of time. [326-20-50-5 – 50-6, 606-10 Glossary, 606-10-45-3]

#### *Contract asset subsequently becomes a receivable*

Once a contract asset becomes a trade receivable (i.e. the related performance condition has been satisfied), the disclosures related to credit quality information, including vintage disclosures, do not apply if those trade receivables are due in one year or less. [326-20-50-9]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

In contrast, such disclosures do apply if the contract asset becomes a receivable that is due after a year; however, the vintage disclosures only apply to PBEs. [326-20-50-9]

## *Examples*

### Excerpt from ASC 326-20

• > Example 15: Disclosing Credit Quality Indicators of Financing Receivables by Amortized Cost Basis

**55-79** The following Example illustrates the presentation of credit quality disclosures for a financial institution with a narrow range of loan products offered to local customers—both consumer and commercial. Depending on the size and complexity of an entity's portfolio of financing receivables, the entity may present disclosures that are more or less detailed than the following Example. An entity may choose other methods of determining the class of financing receivable and may determine different credit quality indicators that reflect how credit risk is monitored. Some entities may have more than one credit quality indicator for certain classes of financing receivables.

| | Term Loans Amortized Cost Basis by Origination Year | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **As of December 31, 20X5** | **20X5** | **20X4** | **20X3** | **20X2** | **20X1** | **Prior** | **Revolving Loans Amortized Cost Basis** | **Revolving Loans Converted to Term Loans Amortized Cost Basis** | **Total** |
| **Residential mortgage:** | | | | | | | | | |
| Risk rating: | | | | | | | | | |
| 1-2 internal grade | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| 3-4 internal grade | - | - | - | - | - | - | - | - | - |
| 5 internal grade | - | - | - | - | - | - | - | - | - |
| 6 internal grade | - | - | - | - | - | - | - | - | - |
| 7 internal grade | - | - | - | - | - | - | - | - | - |
| **Total residential mortgage loans** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** |
| **Residential mortgage loans:** | | | | | | | | | |
| Current-period gross writeoffs | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| **Consumer:** | | | | | | | | | |
| Risk rating: | | | | | | | | | |
| 1-2 internal grade | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| 3-4 internal grade | - | - | - | - | - | - | - | - | - |
| 5 internal grade | - | - | - | - | - | - | - | - | - |
| 6 internal grade | - | - | - | - | - | - | - | - | - |
| 7 internal grade | - | - | - | - | - | - | - | - | - |
| **Total consumer** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** |
| **Consumer loans:** | | | | | | | | | |
| Current-period gross writeoffs | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| **Commercial business:** | | | | | | | | | |
| Risk rating: | | | | | | | | | |
| 1-2 internal grade | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| 3-4 internal grade | - | - | - | - | - | - | - | - | - |
| 5 internal grade | - | - | - | - | - | - | - | - | - |
| 6 internal grade | - | - | - | - | - | - | - | - | - |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| 7 internal grade | - | - | - | - | - | - | - | - | - |
| **Total commercial business** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** |
| **Commercial business loans:** | | | | | | | | | |
| Current-period gross writeoffs | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| **Commercial mortgage** | | | | | | | | | |
| Risk rating: | | | | | | | | | |
| 1-2 internal grade | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |
| 3-4 internal grade | - | - | - | - | - | - | - | - | - |
| 5 internal grade | - | - | - | - | - | - | - | - | - |
| 6 internal grade | - | - | - | - | - | - | - | - | - |
| 7 internal grade | - | - | - | - | - | - | - | - | - |
| **Total commercial mortgage** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** | **$ -** |
| **Commercial mortgage loans:** | | | | | | | | | |
| Current-period gross writeoffs | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - | $ - |

## **Example 24.2.10** Disclosing credit quality of HTM debt securities

The following table illustrates a credit quality disclosure for an entity that holds a portfolio of HTM debt securities.

Depending on the size and complexity of its portfolio, an entity may present disclosures that are more or less detailed than this example. For instance, this sample disclosure uses just one credit quality indicator (credit rating), but some entities may decide to present more than one credit quality indicator.

| As of December 31, 20XX | Amortized cost of HTM debt securities by credit rating | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | AAA | AA | A | BBB | BB | B | CCC – C | Total |
| US Treasury and government agencies | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Obligations of US states and municipalities | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Corporate debt securities | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential MBS | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential MBS issued by US government-sponsored enterprises or US government agencies | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Commercial MBS | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Total | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.2.30 Allowance for credit losses

### Excerpt from ASC 326-20

> Allowance for Credit Losses

**50-10** An entity shall provide information that enables a financial statement user to do the following:

a. Understand management's method for developing its allowance for credit losses
b. Understand the information that management used in developing its current estimate of expected credit losses
c. Understand the circumstances that caused changes to the allowance for credit losses, thereby affecting the related credit loss expense (or reversal) reported for the period.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-10** For interim and annual reporting periods, an~~An~~ entity shall provide information that enables a financial statement user to do the following: …

**50-11** To meet the objectives in paragraph 326-20-50-10, an entity shall disclose all of the following by **portfolio segment** and major security type:

a. A description of how expected loss estimates are developed
b. A description of the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of expected credit losses, including:
   1. Past events
   2. Current conditions
   3. Reasonable and supportable forecasts about the future.
c. A discussion of risk characteristics relevant to each portfolio segment
d. A discussion of the changes in the factors that influenced management's current estimate of expected credit losses and the reasons for those changes (for example, changes in portfolio composition, underwriting practices, and significant events or conditions that affect the current estimate but were not contemplated or relevant during a previous period)
e. Identification of changes to the entity's accounting policies, changes to the methodology from the prior period, its rationale for those changes, and the quantitative effect of those changes
f. Reasons for significant changes in the amount of writeoffs, if applicable
g. A discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period
h. The amount of any significant purchases of financial assets during each reporting period
i. The amount of any significant sales of financial assets or reclassifications of loans held for sale during each reporting period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-11** To meet the objectives in paragraph 326-20-50-10, an entity shall disclose all of the following by **portfolio segment** and major security type in interim and annual reporting periods: …

**50-12** Paragraph 326-20-45-3 explains that a creditor that measures expected credit losses based on a discounted cash flow method is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense) but also may report the change in present value attributable to the passage of time as interest income. Creditors that choose the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-12** Paragraph 326-20-45-3 explains that a creditor that measures expected credit losses based on a discounted cash flow method is permitted to report the entire change in present value as credit loss expense (or reversal of credit loss expense) but also may report the change in present value attributable to the passage of time as interest income. Creditors that choose the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time in interim and annual reporting periods.

The disclosures about the allowance for credit losses are designed to help financial statement users understand: [326-20-50-10]

- management's method for developing its allowance for credit losses;
- the information that management used in developing its current estimate of expected credit losses; and
- the circumstances that caused changes to the allowance for credit losses, thereby affecting the related credit loss expense (or reversal) reported for the period.

## **Question 24.2.100** What disclosures are required about the allowance for credit losses?

**Interpretive response:** The following disclosures are required, by portfolio segment and major security type: [326-20-50-11]

- a description of how expected loss estimates are developed;
- a description of the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

factors that influenced management's current estimate of expected credit losses, including:

  — past events;
  — current conditions; and
  — reasonable and supportable forecasts about the future;

- a discussion of risk characteristics relevant to each portfolio segment;
- a discussion of the changes in the factors that influenced management's current estimate of expected credit losses and the reasons for those changes – e.g. changes in portfolio composition, underwriting practices, and significant events or conditions that affect the current estimate but were not contemplated or relevant during a previous period;
- identification of changes to the entity's accounting policies, changes to the methodology from the prior period, its rationale for those changes, and the quantitative effect of those changes;
- reasons for significant changes in the amount of writeoffs, if applicable;
- a discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period (see Question 24.2.120);
- the amount of any significant purchases of financial assets during each reporting period; and
- the amount of any significant sales of financial assets or reclassifications of loans held for sale during each reporting period.

Incremental disclosure may be required when expected credit losses are estimated using a discounted cash flow method (see Question 24.2.110).

## **Question 24.2.110** What incremental disclosures are required when expected credit losses are estimated using a discounted cash flow method?

**Background:** When an entity estimates expected credit losses based on a discounted cash flow method, the change in present value from one reporting period to the next may result from the passage of time and a change in the estimate of future expected cash flows.

As discussed in section 23.2.20, an entity has the option of reporting the change in present value as follows: [326-20-45-3]

- the entire change in present value may be reported as credit loss expense (or reversal of credit loss expense); or
- the change in present value attributable to the passage of time may be reported as interest income and the remainder as credit loss expense.

**Interpretive response:** If an entity reports the change in present value attributable to the passage of time as interest income, it discloses that amount. [326-20-50-12]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## **Question 24.2.120** What information does an entity disclose about the reversion method?

**Background:** Subtopic 326-20 does not prescribe how an entity should revert to historical loss information. Instead, it indicates that an entity could revert immediately, on a straight-line basis, or using another rational and systematic basis. [326-20-30-9]

**Interpretive response:** An entity is required to include in its disclosures a discussion of the reversion method applied for periods beyond the reasonable and supportable forecast period. [326-20-50-11(g)]

We believe an entity should disclose the specific method used to revert to historical loss information – i.e. immediately, on a straight-line basis, or another rational and systematic method. If another rational and systematic method is used, we believe an entity should describe the method to enable financial statement users to understand the qualitative impact on the allowance for credit losses.

## **Question 24.2.130** Does an entity disclose whether single or multiple economic scenarios are used to develop its economic forecast?

**Background:** An entity is required to include in its disclosures a description of how expected loss estimates are developed and the entity's accounting policies and methodology to estimate the allowance for credit losses, as well as a discussion of the factors that influenced management's current estimate of expected credit losses, including: [326-20-50-11(a) – 50-11(b)]

- past events;
- current conditions; and
- reasonable and supportable forecasts about the future.

**Interpretive response:** We believe an entity should disclose whether it uses a single or multiple forward-looking economic scenarios as part of its disclosures about the methodology for estimating the allowance for credit losses. In most circumstances, this information is important to enable financial statement users to understand the entity's methodology, how the entity developed its expected loss estimates, and the factors that influenced management's estimate.

## **Question 24.2.140** Does an entity disclose what the reasonable and supportable forecast period is?

**Interpretive response:** We believe an entity should disclose the reasonable and supportable forecast period as part of the disclosures about the methodology for estimating the allowance for credit losses. Such information is generally an important input to enable financial statement users to understand the methodology for estimating expected credit losses. [326-20-50-11(a) – 50-11(b)]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.2.40 Roll-forward of the allowance for credit losses

### Excerpt from ASC 326-20

> Rollforward of the Allowance for Credit Losses

**50-13** Furthermore, to enable a financial statement user to understand the activity in the allowance for credit losses for each period, an entity shall separately provide by **portfolio segment** and major security type the quantitative disclosures of the activity in the allowance for credit losses for **financial assets** within the scope of this Subtopic, including all of the following:

a. The beginning balance in the allowance for credit losses
b. Current-period provision for expected credit losses
c. The initial allowance for credit losses recognized on financial assets accounted for as **purchased financial assets with credit deterioration** (including beneficial interests that meet the criteria in paragraph 325-40-30-1A), if applicable
cc. The initial allowance for credit losses recognized on financial assets accounted for as **purchased seasoned loans**
d. Writeoffs charged against the allowance
e. Recoveries collected
f. The ending balance in the allowance for credit losses.

**Pending Content**

Transition Date: (P) December 16, 2026; (N) December 16, 2026 | Transition Guidance: 220-40-65-1

**50-13** …

See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-13** Furthermore, to enable … , including all of the following in interim and annual reporting periods: …

The disclosures about the roll-forward of the allowance for credit losses are designed to help financial statement users understand the activity in the allowance for credit losses for each period. [326-20-50-13]

### Question 24.2.150 What disclosures are required about the roll-forward of the allowance for credit losses?#

**Interpretive response:** The following disclosures are required separately by portfolio segment and major security type: [326-20-50-13]

- the beginning balance in the allowance for credit losses;
- the current period provision for expected credit losses;

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- the initial allowance for credit losses recognized on financial assets accounted for as purchased financial assets with credit deterioration, including beneficial interests that meet the criteria in paragraph 325-40-30-1A, if applicable;
- the initial allowance for credit losses recognized on financial assets accounted for as PSLs;
- writeoffs charged against the allowance;
- recoveries collected; and
- the ending balance in the allowance for credit losses.

**Note:** These disclosures will not include any amounts for PSLs until an entity adopts ASU 2025-08. See section 25.3 regarding effective dates.

## 24.2.50 Past-due status

### Excerpt from ASC 326-20

> Past Due Status

**50-14** To enable a financial statement user to understand the extent of **financial assets** that are past due, an entity shall provide an aging analysis of the **amortized cost basis** for financial assets that are past due as of the reporting date, disaggregated by **class of financing receivable** and major security type. An entity also shall disclose when it considers a financial asset to be past due.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-14** … The disclosures in this paragraph are required in interim and annual reporting periods.

**50-15** The requirements to disclose past-due status in paragraph 326-20-50-14 do not apply to receivables measured at the lower of amortized cost basis or **fair value**, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-15** The requirements to disclose past-due status in paragraph 326-20-50-14 in interim and annual reporting periods do not apply to receivables measured at the lower of amortized cost basis or **fair value**, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

The disclosures about past-due status are designed to help financial statement users understand the extent of financial assets that are past due. [326-20-50-14]

## Question 24.2.160 What disclosures are required about past-due status?

**Interpretive response:** An aging analysis of the amortized cost basis is required for financial assets that are past due as of the reporting date, disaggregated by class of financing receivable and major security type. [326-20-50-14]

An entity also discloses when it considers a financial asset to be past due. [326-20-50-14]

The aging analysis for financing receivables is illustrated in Subtopic 326-20's Example 16 (reproduced below) and the aging analysis for HTM debt securities is illustrated in Example 24.2.20.

These past-due status disclosures apply to all financial assets in the scope of Subtopic 326-20, except for the following receivables: [326-20-50-15]

- receivables measured at the lower of amortized cost basis or fair value; or
- trade receivables due in one year or less (except for credit card receivables) that result from revenue transactions in the scope of Topic 606 (revenue from customer contracts) or legacy Topic 605 (revenue recognition).

### Excerpt from ASC 326-20

• > Example 16: Disclosing Past-Due Status

**55-80** The following table illustrates certain of the disclosures in paragraph 326-20-50-14 by class of financing receivable.

| | Age Analysis of Past-Due Financial Assets As of December 31, 20X5, and 20X4 Past Due | | | | | | |
|---|---|---|---|---|---|---|---|
| **20X5** | **30-59 Days** | **60-89 Days** | **Greater Than 90 Days** | **Total** | **Current** | **Total** | **Amortized Cost > 90 Days and Accruing** |
| Commercial | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX |
| Commercial real estate: | | | | | | | |
| Commercial real estate – construction | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Commercial real estate – other | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer: | | | | | | | |
| Consumer – credit card | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer – other | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer – auto | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential: | | | | | | | |
| Residential – prime | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Residential – subprime | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Finance leases | | | | | | | |
| **Total** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** |

| | Age Analysis of Past-Due Financial Assets As of December 31, 20X5, and 20X4 Past Due | | | | | | |
|---|---|---|---|---|---|---|---|
| **20X4** | **30-59 Days** | **60-89 Days** | **Greater Than 90 Days** | **Total** | **Current** | **Total** | **Amortized Cost > 90 Days and Accruing** |
| Commercial | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX | $XX,XXX |
| Commercial real estate: | | | | | | | |
| Commercial real estate – construction | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Commercial real estate – other | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer: | | | | | | | |
| Consumer – credit card | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer – other | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Consumer – auto | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential: | | | | | | | |
| Residential – prime | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential – subprime | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Finance leases | | | | | | | |
| **Total** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** | **$XX,XXX** |

## **Example 24.2.20** Disclosing past-due status of HTM debt securities

The following table illustrates the disclosure of past-due status for an entity that holds a portfolio of debt securities classified as HTM.

| | Aging analysis of past-due HTM debt securities | | | | | |
|---|---|---|---|---|---|---|
| **As of December 31, 20XX** | **30-59 days** | **60-89 days** | **Greater than 90 days** | **Total** | **Current** | **Total** |
| US Treasury and government agencies | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Obligations of US states and municipalities | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Corporate debt securities | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential MBS | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Residential MBS issued by US government-sponsored enterprises or US government agencies | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| As of December 31, 20XX | Aging analysis of past-due HTM debt securities | | | | | |
|---|---|---|---|---|---|---|
| | 30-59 days | 60-89 days | Greater than 90 days | Total | Current | Total |
| Commercial MBS | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |
| Total | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX | XX,XXX |

## 24.2.60 Nonaccrual status

### Excerpt from ASC 326-20

> Nonaccrual Status

**50-16** To enable a financial statement user to understand the credit risk and interest income recognized on **financial assets** on nonaccrual status, an entity shall disclose all of the following, disaggregated by class of **financing receivable** and major security type:

a. The **amortized cost basis** of financial assets on nonaccrual status as of the beginning of the reporting period and the end of the reporting period
b. The amount of interest income recognized during the period on nonaccrual financial assets
c. The amortized cost basis of financial assets that are 90 days or more past due, but are not on nonaccrual status as of the reporting date
d. The amortized cost basis of financial assets on nonaccrual status for which there is no related allowance for credit losses as of the reporting date.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-16** To enable a financial statement user to understand the credit risk and interest income recognized on **financial assets** on nonaccrual status, an entity shall disclose all of the following, disaggregated by class of **financing receivable** and major security type, in interim and annual reporting periods: …

**50-17** An entity's summary of significant accounting policies for financial assets within the scope of this Subtopic shall include all of the following:

a. Nonaccrual policies, including the policies for discontinuing accrual of interest, recording payments received on nonaccrual assets (including the cost recovery method, cash basis method, or some combination of those methods), and resuming accrual of interest, if applicable
b. The policy for determining past-due or delinquency status
c. The policy for recognizing writeoffs within the allowance for credit losses.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-17** For interim and annual reporting periods, an~~An~~ entity's summary of significant accounting policies for financial assets within the scope of this Subtopic shall include all of the following: …

**50-18** The requirements to disclose nonaccrual status in paragraphs 326-20-50-16 through 50-17 do not apply to receivables measured at lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-18** The requirements to disclose nonaccrual status in paragraphs 326-20-50-16 through 50-17 in interim and annual reporting periods do not apply to receivables measured at lower of amortized cost basis or fair value, or trade receivables due in one year or less, except for credit card receivables, that result from revenue transactions within the scope of Topic 605 on revenue recognition or Topic 606 on revenue from contracts with customers.

The disclosures about nonaccrual status are designed to help financial statement users understand the credit risk and interest income recognized on financial assets on nonaccrual status. The requirements include quantitative disclosures and disclosures about an entity's policies. [326-20-50-16 – 50-17]

## **Question 24.2.170** What quantitative disclosures are required about nonaccrual status?

**Interpretive response:** The following amounts are disclosed, disaggregated by class of financing receivable and major security type: [326-20-50-16]

- the amortized cost basis of financial assets on nonaccrual status as of the beginning and the end of the reporting period;
- the amount of interest income recognized during the period on nonaccrual financial assets;
- the amortized cost basis of financial assets that are 90 days or more past due, but are not on nonaccrual status as of the reporting date; and
- the amortized cost basis of financial assets on nonaccrual status for which there is no related allowance for credit losses as of the reporting date.

These nonaccrual status disclosures apply to financial assets in the scope of Subtopic 326-20, except for the following receivables: [326-20-50-18]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- receivables measured at the lower of amortized cost basis or fair value; or
- trade receivables due in one year or less (except for credit card receivables) that result from revenue transactions in the scope of Topic 606 (revenue from customer contracts) or legacy Topic 605 (revenue recognition).

### **Question 24.2.180** What disclosures are required about an entity's nonaccrual status policies?

**Interpretive response:** In its summary of significant accounting policies, an entity describes the following for financial assets in the scope of Subtopic 326-20: [326-20-50-17]

- its nonaccrual policies, including the policies for:
  - discontinuing accrual of interest;
  - recording payments received on nonaccrual assets, including the cost recovery method, cash basis method or some combination of those methods; and
  - resuming accrual of interest, if applicable
- its policy for determining past-due or delinquency status; and
- its policy for recognizing writeoffs within the allowance for credit losses.

## 24.2.70 PCD financial assets

### Excerpt from ASC 326-20

> Purchased Financial Assets with Credit Deterioration

**50-19** To the extent an entity acquired **purchased financial assets with credit deterioration** during the current reporting period, an entity shall provide a reconciliation of the difference between the purchase price of the **financial assets** and the par value of the assets, including:

a. The purchase price
b. The allowance for credit losses at the acquisition date based on the acquirer's assessment
c. The discount (or premium) attributable to other factors
d. The par value.

A purchased financial asset with credit deterioration (PCD asset) is an asset that on its acquisition date had experienced a more-than-insignificant deterioration in credit quality since origination or issuance. See chapter 12. [326-20 Glossary]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 24.2.190** What disclosures are required for PCD assets?

**Interpretive response:** When an entity acquires PCD assets during the current reporting period, it reconciles the purchase price of the financial assets to their par values. This reconciliation includes: [326-20-50-19]

- the purchase price;
- the allowance for credit losses at the acquisition date (based on the acquirer's assessment);
- the discount or premium attributable to other factors; and
- the par value.

## 24.2.80 Collateral-dependent financial assets

### Excerpt from ASC 326-20

> Collateral-Dependent Financial Assets

**50-20** For a **financial asset** for which the repayment (on the basis of an entity's assessment as of the reporting date) is expected to be provided substantially through the operation or sale of the collateral and the borrower is experiencing financial difficulty, an entity shall describe the type of collateral by **class of financing receivable** and major security type. The entity also shall qualitatively describe, by class of financing receivable and major security type, the extent to which collateral secures its collateral-dependent financial assets, and significant changes in the extent to which collateral secures its collateral-dependent financial assets, whether because of a general deterioration or some other reason.

A financial asset is collateral-dependent when the borrower is experiencing financial difficulty and repayment is expected to be provided substantially through the sale or operation of the collateral. See section 10.2. [326-20-50-20]

### **Question 24.2.200** What disclosures are required for collateral-dependent financial assets?

**Interpretive response:** The following required disclosures are made by class of financing receivable and major security type: [326-20-50-20]

- a description of the type of collateral;
- the extent to which collateral secures collateral-dependent financial assets; and
- significant changes in the extent to which collateral secures collateral dependent financial assets, whether because of a general deterioration or some other reason.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.2.85 Simplifications for current accounts receivable and contract assets**

### Excerpt from ASC 326-20

• > Practical Expedient and Accounting Policy Election for Current Accounts Receivable and Current Contract Assets

**50-12A** An entity shall disclose that it has elected the practical expedient described in paragraphs 326-20-30-10C through 30-10D or, for an entity other than a public business entity, that it has elected both the practical expedient and the accounting policy election described in paragraphs 326-20- 30-10E through 30-10H.

**50-12B** In annual reporting periods, an entity other than a public business entity that has elected the accounting policy described in paragraphs 326-20-30-10E through 30-10H shall disclose the date through which it has considered subsequent collection activity.

Subtopic 326-20 provides two simplifications that can be used when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606 (revenue from contracts with customers); see section 10.4.

### **Question 24.2.205** What disclosures are required when an entity elects the simplified guidance for current accounts receivable and contract assets?

**Interpretive response:** The following disclosures are required, depending on the simplification applied.

| Simplification | Disclosure |
|---|---|
| **Practical expedient to assume current conditions do not change**<br>See section 10.4.20. | • Disclose election of the practical expedient. [326-20-50-12A] |
| **Accounting policy to consider subsequent collection activity**<br>See section 10.4.30. | • Disclose election of the practical expedient. [326-20-50-12A]<br>• Disclose the date through which the entity has considered subsequent collection activity. [326-20-50-12B] |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.2.90 Off-balance sheet credit exposures

### Excerpt from ASC 326-20

> Off-Balance-Sheet Credit Exposures

**50-21** In addition to disclosures required by other Topics, an entity shall disclose a description of the accounting policies and methodology the entity used to estimate its liability for off-balance-sheet credit exposures and related charges for those credit exposures. Such a description shall identify the factors that influenced management's judgment (for example, historical losses, existing economic conditions, and reasonable and supportable forecasts) and a discussion of risk elements relevant to particular categories of financial instruments.

**50-22** Off-balance-sheet credit exposures refers to credit exposures on off-balance-sheet **loan commitments**, **standby letters of credit**, financial guarantees not accounted for as insurance, and other similar instruments, except for instruments within the scope of Topic 815.

The term 'off-balance sheet credit exposures' refers to credit exposures on off-balance sheet loan commitments, standby letters of credit, financial guarantees (not accounted for as insurance contracts or a derivative), and other similar instruments. See chapter 13. [326-20-50-22]

### Question 24.2.210 What disclosures are required for off-balance sheet credit exposures?

**Interpretive response:** In addition to disclosures required by other Topics, Subtopic 326-20 requires an entity to describe the accounting policies and methodology it used to estimate its liability for such exposures and any related charges. This description must: [326-20-50-21]

- identify the factors that influenced management's judgment – e.g. historical losses, existing economic conditions and reasonable and supportable forecasts; and
- discuss the risk elements relevant to particular categories of financial instruments.

## 24.2.100 Accrued interest receivable

### Excerpt from ASC 326-20

**50-3A** An entity that makes an accounting policy election to present the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-20-45-5 shall disclose the amount of accrued interest, net of the allowance for credit losses (if any), and

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

shall disclose in which line item on the statement of financial position that amount is presented.

**50-3B** As a practical expedient, an entity may exclude the accrued interest receivable balance that is included in the amortized cost basis of financing receivables and held-to-maturity securities for the purposes of the disclosure requirements in paragraphs 326-20-50-4 through 50-22. If an entity applies this practical expedient, it shall disclose the total amount of accrued interest excluded from the disclosed amortized cost basis.

**50-3C** An entity that makes the accounting policy election in paragraph 326-20-30-5A shall disclose its accounting policy not to measure an allowance for credit losses for accrued interest receivables. The accounting policy shall include information about what time period or periods, at the class of financing receivable or major security-type level, are considered timely.

**50-3D** An entity that makes the accounting policy election in paragraph 326-20-35-8A shall disclose its accounting policy to write off accrued interest receivables by reversing interest income or recognizing credit loss expense or a combination of both. The entity also shall disclose the amount of accrued interest receivables written off by reversing interest income by portfolio segment or major security type.

## **Question 24.2.220** What disclosures are required about an entity's elections related to accrued interest receivable?

**Interpretive response:** There are four elections an entity can make related to the measurement, presentation and disclosure of accrued interest receivable. The following table lists the disclosure requirement for each election.

| Election | Disclosure requirement |
|---|---|
| Present accrued interest receivable separately from the associated financial asset (see Question 23.2.05) | Disclose the amount of accrued interest, net of the allowance for credit losses (if any), and the line item in which that amount is presented. [326-20-50-3A] |
| Exclude the accrued interest receivable that is included in the amortized cost of certain financial instruments from the disclosure requirements in paragraphs 326-20-50-4 to 50-22 (see Question 24.2.20) | Disclose the total amount of accrued interest excluded from the disclosed amortized cost basis. [326-20-50-3B] |
| Not to measure an allowance for credit losses for accrued interest receivable when the entity writes off accrued interest receivable in a timely manner (see section 4.2.20) | Disclose that accounting policy election, including information about what time periods are considered timely (at the class of financing receivable or major security-type level). [326-20-50-3C] |
| To write off accrued interest receivable by reversing interest income, recognizing | Disclose the elected accounting policy and – if applicable – the amount written off by reversing interest income, by |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Election | Disclosure requirement |
|---|---|
| credit loss expense, or a combination of both (see Question 4.2.50) | portfolio segment or major security type. [326-20-50-3D] |

## 24.3 AFS debt securities (Subtopic 326-30)

### 24.3.10 Overview

**Excerpt from ASC 326-30**

**50-1** For instruments within the scope of this Subtopic, this Section provides the following disclosure guidance related to credit risk and the measurement of credit losses:

a. **Available-for-sale debt securities** in unrealized loss positions without an allowance for credit losses
b. Allowance for credit losses
c. **Purchased financial assets with credit deterioration**.

**50-2** The disclosure guidance in this Section should enable a user of the financial statements to understand the following:

a. The credit risk inherent in available-for-sale debt securities
b. Management's estimate of credit losses
c. Changes in the estimate of credit losses that have taken place during the period.

**50-3** An entity shall determine, in light of the facts and circumstances, how much detail it must provide to satisfy the disclosure requirements in this Section and how it disaggregates information into major security types. An entity must strike a balance between obscuring important information as a result of too much aggregation and overburdening financial statements with excessive detail that may not assist a financial statement user to understand an entity's securities and allowance for credit losses. For example, an entity should not obscure important information by including it with a large amount of insignificant detail. Similarly, an entity should not disclose information that is so aggregated that it obscures important differences between the different types of **financial assets** and associated risks.

Financial statement disclosures about AFS debt securities are intended to provide information that is useful in analyzing: [326-30-50-2]

- the credit risk inherent in AFS debt securities;
- management's estimate of credit losses; and
- changes in the estimate of credit losses that have taken place during the period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 24.3.10** How are disclosures for AFS debt securities disaggregated?

**Interpretive response:** Disclosures for such securities are disaggregated by major security type. Judgment is necessary to determine the level of aggregation and level of detail for these disclosures. In making these determinations, an entity needs to balance two competing concerns. [326-30-50-3]

- On one hand, the information should not be aggregated to such a degree that important information is obscured.
- On the other hand, the information should not be disaggregated to such a degree that the financial statement users are overburdened with excessive detail that is not decision useful.

### **Question 24.3.20** Must accrued interest receivable be included in disclosures of the amortized cost of AFS debt securities?

**Interpretive response:** No. Due to stakeholder concerns, the FASB provided relief for the measurement (see section 19.4.30), presentation (see Question 23.3.10) and disclosure requirements for accrued interest receivable balances when an entity excludes accrued interest receivable from both the fair value and amortized cost basis of AFS debt securities for purposes of identifying and measuring impairment.

Specifically, an entity is permitted, as a practical expedient, to exclude accrued interest receivable included in an instrument's amortized cost from the disclosure requirements in paragraphs 326-30-50-4 to 50-10 (see sections 24.3.20 to 24.3.50). If an entity elects the practical expedient, it discloses the total amount of accrued interest excluded from the disclosed amortized cost basis. [326-30-50-3B]

See section 24.3.60 for further information about disclosures related to accrued interest receivable.

## 24.3.20 AFS debt securities in unrealized loss positions without an allowance for credit losses

#### Excerpt from ASC 326-30

> Available-for-Sale Debt Securities in Unrealized Loss Positions without an Allowance for Credit Losses

**50-4** For **available-for-sale debt securities**, including those that fall within the scope of Subtopic 325-40 on beneficial interests in securitized financial assets, in an unrealized loss position for which an allowance for credit losses has not

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

been recorded, an entity shall disclose all of the following in its interim and annual financial statements:

a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment—each major security type that the entity discloses in accordance with this Subtopic—in tabular form:
   1. The aggregate related fair value of investments with unrealized losses
   2. The aggregate amount of unrealized losses (that is, the amount by which amortized cost basis exceeds fair value).
b. As of the date of the most recent statement of financial position, additional information (in narrative form) that provides sufficient information to allow a financial statement user to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that an allowance for credit losses is unnecessary. The disclosures required may be aggregated by investment categories, but individually significant unrealized losses generally shall not be aggregated. This disclosure could include all of the following:
   1. The nature of the investment(s)
   2. The cause(s) of the impairment(s)
   3. The number of investment positions that are in an unrealized loss position
   4. The severity of the impairment(s)
   5. Other evidence considered by the investor in reaching its conclusion that an allowance for credit losses is not necessary, including, for example, any of the following:
      i. Performance indicators of the underlying assets in the security, including any of the following:
         01 Default rates
         02 Delinquency rates
         03 Percentage of nonperforming assets.
      ii. Debt-to-collateral-value ratios
      iii. Third-party guarantees
      iv. Current levels of subordination
      v. Vintage
      vi. Geographic concentration
      vii. Industry analyst reports
      viii. Credit ratings
      ix. Volatility of the security's fair value
      x. Interest rate changes since purchase
      xi. Any other information that the investor considers relevant.

**50-5** The disclosures in (a)(1) through (a)(2) in paragraph 326-30-50-4 shall be disaggregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-5** For interim and annual reporting periods, the~~The~~ disclosures in (a)(1) through (a)(2) in paragraph 326-30-50-4 shall be disaggregated by

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer.

**50-6** The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-6** … For entities that do not prepare interim financial ~~information~~ statements and notes in accordance with generally accepted accounting principles, the reference point is the annual balance sheet date of the period during which the impairment was identified. …

Both quantitative and narrative disclosures are required for AFS debt securities in an unrealized loss position for which an allowance for credit losses has not been recognized. Subtopic 326-30's Example 2 (reproduced further below) illustrates these disclosures.

## **Question 24.3.30** What are the quantitative disclosures required for AFS debt securities in an unrealized loss position without an allowance for credit losses?

**Interpretive response:** If an allowance for credit losses has not been recognized for securities in an unrealized loss position, then the following interim and annual quantitative disclosures are required: [326-30-50-4(a)]

- as of each date for which a balance sheet is presented, quantitative information in tabular format and aggregated by category of investment – i.e. each major security type that the entity discloses under Subtopic 326-30:
  - — the aggregate related fair value of investments with unrealized losses; and
  - — the aggregate amount of unrealized losses – i.e. the amount by which amortized cost basis exceeds fair value.

| Related guidance on tabular disclosure of fair value and unrealized losses |
|---|
| AFS securities that are in the scope of Subtopic 325-40 (beneficial interests in securitized financial assets) are subject to these disclosures. [326-30-50-4] |
| These disclosures are disaggregated by those investments that have been in a continuous unrealized loss position for fewer than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer. [326-30-50-5] |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Related guidance on tabular disclosure of fair value and unrealized losses |
| --- |
| The reference point for determining how long an investment has been in a continuous unrealized loss position is the reporting date of the period in which the impairment is identified. For entities that do not prepare interim financial information, the reference point is the reporting date of the annual period during which the impairment was identified. [326-30-50-6] |
| The continuous unrealized loss position ceases upon the investor becoming aware of a recovery of fair value up to (or beyond) the amortized cost basis of the investment during the period. [326-30-50-6] |

## **Question 24.3.40** What are the narrative disclosures required for AFS debt securities in an unrealized loss position without an allowance for credit losses?

**Interpretive response:** If an allowance for credit losses has not been recognized for securities in an unrealized loss position, additional information (in narrative form) is disclosed that provides sufficient information to allow financial statement users to understand the quantitative disclosures and the information that the entity considered (both positive and negative) in reaching the conclusion that an allowance for credit losses is unnecessary. These qualitative disclosures are made on both an interim and annual basis, and the information disclosed is as of the date of the most recent balance sheet presented. [326-30-50-4(b)]

| Related guidance on information considered when determining whether an allowance for credit losses is unnecessary |
| --- |
| AFS securities that are in the scope of Subtopic 325-40 (beneficial interests in securitized financial assets) are subject to these disclosures. [326-30-50-4] |
| When disclosing why an allowance for credit losses is unnecessary, an entity may aggregate the information by investment category, but individually significant unrealized losses generally are not aggregated. Information relevant to the determination of whether an allowance for credit losses is unnecessary could include: [326-30-50-4(b)]<br>• the nature of the investment(s);<br>• the cause(s) of the impairment(s);<br>• the number of investment positions that are in an unrealized loss position;<br>• the severity of the impairment(s); and<br>• other evidence considered by the investor in reaching its conclusion that an allowance for credit losses is not necessary, including, for example:<br>— performance indicators of the underlying assets in the security, including default rates, delinquency rates, and percentage of nonperforming assets;<br>— debt-to-collateral-value ratios;<br>— third party guarantees;<br>— current levels of subordination;<br>— vintage;<br>— geographic concentration;<br>— industry analyst reports;<br>— credit ratings;<br>— volatility of the security's fair value; |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Related guidance on information considered when determining whether an allowance for credit losses is unnecessary**

— interest rate changes since purchase; and
— any other information that the investor considers relevant.

## Excerpt from ASC 326-30

• > Example 2: Disclosures about Investments in Available-for-Sale Debt Securities in an Unrealized Loss Position with No Credit Losses Reported

**55-8** This Example illustrates the guidance in Section 326-30-50 with a table followed by illustrative narrative disclosures. The table shows the gross unrealized losses and fair value of Entity B's investments with unrealized losses that are not deemed to have credit losses (in millions), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 20X3. This Example illustrates the application of paragraphs 326-30-50-4 through 50-6 and, in doing so, describes Entity B's rationale for not reporting all or a portion of unrealized losses presented in the table as credit losses. In the application of paragraph 326-30-50-4(b), Entity B should provide meaningful disclosure about individually significant unrealized losses. To facilitate the narrative disclosures and for simplicity, this Example presents only the quantitative information as of the date of the latest statement of financial position. However, in accordance with paragraphs 326-30-50-4 through 50-6, that information is required as of each date for which a statement of financial position is presented.

| | Less Than 12 Months | | 12 Months or Greater | | Total | |
|---|---|---|---|---|---|---|
| **Description of Securities** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** | **Fair Value** | **Unrealized Losses** |
| U.S. Treasury obligations and direct obligations of U.S. government agencies | $172 | $ 2 | $58 | $1 | $230 | $ 3 |
| Federal agency mortgage-backed securities | 367 | 5 | 18 | 1 | 385 | 6 |
| Corporate bonds | 150 | 7 | - | - | 150 | 7 |
| **Total** | **$689** | **$14** | **$76** | **$2** | **$765** | **$ 16** |

**55-9** Following are illustrative narrative disclosures that would follow the illustrative table.

> U.S. Treasury obligations. The unrealized losses on Entity B's investments in U.S. Treasury obligations and direct obligations of U.S. government agencies were caused by interest rate increases. The contractual terms of those investments do not permit the issuer to settle the securities at a price less than the amortized cost bases of the investments. Entity B does not intend to sell the investments and it is

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

not more likely than not that Entity B will be required to sell the investments before recovery of their amortized cost bases.

Federal agency mortgage-backed securities. The unrealized losses on Entity B's investment in federal agency mortgage-backed securities were caused by interest rate increases. Entity B purchased those investments at a discount relative to their face amount, and the contractual cash flows of those investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost bases of Entity B's investments. Entity B does not intend to sell the investments and it is not more likely than not that Entity B will be required to sell the investments before recovery of their amortized cost bases.

Corporate bonds. Entity B's unrealized loss on investments in corporate bonds relates to a $150 investment in Entity C's Series C Debentures. Entity C is a manufacturer. The unrealized loss was primarily caused by a recent decrease in profitability and near-term profit forecasts by industry analysts resulting from intense competitive pricing pressure in the manufacturing industry and a recent sector downgrade by several industry analysts. The contractual terms of those investments do not permit Entity C to settle the security at a price less than the amortized cost basis of the investment. While Entity C's credit rating has decreased from A to BBB (Standard & Poor's), Entity B currently does not expect Entity C to settle the debentures at a price less than the amortized cost basis of the investment (that is, Entity B expects to recover the entire amortized cost basis of the security). Entity B does not intend to sell the investment and it is not more likely than not that Entity B will be required to sell the investment before recovery of its amortized cost basis.

## **Question 24.3.50** Do the disclosures for an AFS debt security in an unrealized loss position apply if an allowance for credit losses has been recognized for a portion of the loss?

**Interpretive response:** Yes, we believe disclosure of all unrealized loss amounts related to AFS debt securities is required.

The unrealized loss is the amount by which the amortized cost basis exceeds fair value. The amortized cost basis does not consider the allowance for credit losses. Therefore, we believe the disclosure applies when the unrealized loss on an AFS debt security includes both a credit portion (recognized by establishing an allowance for credit losses) and a non-credit portion (recognized in other comprehensive income). [326-20 Glossary]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.3.30 Allowance for credit losses

### Excerpt from ASC 326-30

> Allowance for Credit Losses

**50-7** For interim and annual periods in which an allowance for credit losses of an **available-for-sale debt security** is recorded, an entity shall disclose by major security type, the methodology and significant inputs used to measure the amount related to credit loss, including its accounting policy for recognizing writeoffs of uncollectible available-for-sale debt securities. Examples of significant inputs include, but are not limited to, all of the following:

a. Performance indicators of the underlying assets in the security, including all of the following:
    1. Default rates
    2. Delinquency rates
    3. Percentage of nonperforming assets
b. Debt-to-collateral-value ratios
c. Third-party guarantees
d. Current levels of subordination
e. Vintage
f. Geographic concentration
g. Industry analyst reports and forecasts
h. Credit ratings
i. Other market data that are relevant to the collectibility of the security.

**50-8** Paragraph 326-30-45-3 explains that an entity may report the change in the allowance for credit losses due to changes in time value as credit loss expense (or reversal of credit loss expense) but also may report the change as interest income. An entity that chooses the latter alternative shall disclose the amount recorded to interest income that represents the change in present value attributable to the passage of time.

**Pending Content**

Transition Date: (P) December 16, 2027; (N) December 16, 2028 | Transition Guidance: 270-10-65-1

**50-8** … An entity that chooses the latter alternative shall disclose in interim and annual reporting periods the amount recorded to interest income that represents the change in present value attributable to the passage of time.

### Question 24.3.60 What disclosures are required about the allowance for credit losses?

**Interpretive response:** If an allowance for credit losses is recorded for AFS securities in an interim or annual period, an entity discloses the methodology and significant inputs used to estimate the allowance, including its accounting

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

policy for recognizing writeoffs of uncollectible AFS debt securities. These disclosures are disaggregated by major security type. [326-30-50-7]

***Examples of significant inputs***

Examples of significant inputs include (non-exclusive): [326-30-50-7]

- performance indicators of the underlying assets in the security, including all of the following:
  - default rates;
  - delinquency rates; and
  - percentage of nonperforming assets;
- debt-to-collateral-value ratios;
- third-party guarantees;
- current levels of subordination;
- vintage;
- geographic concentration;
- industry analyst reports and forecasts;
- credit ratings; and
- other market data that are relevant to the collectibility of the security.

## **Question 24.3.70** What incremental disclosures are required for the change in present value of cash flows expected to be collected?

**Background:** Subtopic 326-30 requires an entity to use a discounted cash flow method to estimate a credit loss (see section 19.4). When a discounted cash flow method is used, the change in present value from one reporting period to the next may result from the passage of time and a change in the estimate of future expected cash flows.

As discussed in section 23.3.10, an entity has the option of reporting the change in present value as follows: [326-30-45-3]

- the entire change in present value may be reported as credit loss expense (or reversal of credit loss expense); or
- the change in present value attributable to the passage of time may be reported as interest income and the remainder as credit loss expense.

**Interpretive response:** If an entity reports the change in present value attributable to the passage of time as interest income, it discloses that amount. [326-30-50-8]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 24.3.40 Roll-forward of the allowance for credit losses

### Excerpt from ASC 326-30

> Rollforward of the Allowance for Credit Losses

**50-9** For each interim and annual reporting period presented, an entity shall disclose by major security type, a tabular rollforward of the allowance for credit losses, which shall include, at a minimum, all of the following:

a. The beginning balance of the allowance for credit losses on **available-for-sale debt securities** held by the entity at the beginning of the period
b. Additions to the allowance for credit losses on securities for which credit losses were not previously recorded
c. Additions to the allowance for credit losses arising from purchases of available-for-sale debt securities accounted for as purchased financial assets with credit deterioration (including beneficial interests that meet the criteria in paragraph 325-40-30-1A)
d. Reductions for securities sold during the period (realized)
e. Reductions in the allowance for credit losses because the entity intends to sell the security or more likely than not will be required to sell the security before recovery of its **amortized cost basis**
f. If the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, additional increases or decreases to the allowance for credit losses on securities that had an allowance recorded in a previous period
g. Writeoffs charged against the allowance
h. Recoveries of amounts previously written off
i. The ending balance of the allowance for credit losses related to debt securities held by the entity at the end of the period.

**Pending Content**

Transition Date: (P) December 16, 2026; (N) December 16, 2026 | Transition Guidance: 220-40-65-1

**50-9** …

See paragraphs 220-40-50-21 through 50-25 for additional disclosure requirements.

## Question 24.3.80 What disclosures are required about the roll-forward of the allowance for credit losses?

**Interpretive response:** For each interim and annual reporting period presented, an entity discloses by major security type a tabular roll-forward of the allowance for credit losses. At a minimum, this tabular disclosure must include: [326-30-50-9]

- the beginning balance of the allowance for credit losses on AFS debt securities held by the entity at the beginning of the period;

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- additions to the allowance for credit losses on securities for which credit losses were not previously recorded;
- additions to the allowance for credit losses arising from purchases of AFS debt securities accounted for as PCD financial assets, including beneficial interests that meet the criteria in paragraph 325-40-30-1A;
- reductions for securities sold during the period (realized);
- reductions in the allowance for credit losses because the entity intends to sell the security or more likely than not will be required to sell the security before recovery of its amortized cost basis;
- if the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery of its amortized cost basis, additional increases or decreases to the allowance for credit losses on securities that had an allowance recorded in a previous period;
- writeoffs charged against the allowance;
- recoveries of amounts previously written off; and
- the ending balance of the allowance for credit losses related to debt securities held by the entity at the end of the period.

## 24.3.50 PCD financial assets

### Excerpt from ASC 326-30

> Purchased Financial Assets with Credit Deterioration

**50-10** To the extent an entity acquired purchased financial assets with credit deterioration during the current reporting period, an entity shall provide a reconciliation of the difference between the purchase price of the assets and the par value of the available-for-sale debt securities, including:

a. The purchase price
b. The allowance for credit losses at the acquisition date based on the acquirer's assessment
c. The discount (or premium) attributable to other factors
d. The par value.

### **Question 24.3.90** What disclosures are required for PCD financial assets classified as AFS debt securities?

**Interpretive response:** When an entity acquires PCD assets during the current reporting period, it reconciles the purchase price of the assets to their par values. This reconciliation must include: [326-30-50-10]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

- the purchase price;
- the allowance for credit losses at the acquisition date based on the acquirer's assessment;
- the discount (or premium) attributable to other factors; and
- the par value.

## 24.3.60 Accrued interest receivable

### Excerpt from ASC 326-30

**50-3A** An entity that makes the accounting policy election to present separately the accrued interest receivable balance within another statement of financial position line item as described in paragraph 326-30-45-1 shall disclose the amount of applicable accrued interest, net of the allowance for credit losses (if any), and shall disclose in which line item on the statement of financial position that amount is presented.

**50-3B** If for the purposes of identifying and measuring an impairment the applicable accrued interest is excluded from both the **fair value** and the **amortized cost basis** of the available-for-sale debt security, an entity may, as a practical expedient, exclude the applicable accrued interest that is included in the amortized cost basis for the purposes of the disclosure requirements in paragraphs 326-30-50-4 through 50-10. If an entity elects this practical expedient, it shall disclose the total amount of accrued interest, net of the allowance for credit losses (if any), excluded from the disclosed amortized cost basis.

**50-3C** An entity that makes the accounting policy election in paragraph 326-30-30-1B shall disclose its accounting policy not to measure an allowance for credit losses for accrued interest receivables. The accounting policy shall include information about what time period or periods, at the major security-type level, are considered timely.

**50-3D** An entity that makes the accounting policy election in paragraph 326-30-35-13A shall disclose its accounting policy to write off accrued interest receivables by reversing interest income or recognizing credit loss expense or a combination of both. The entity also shall disclose the amount of accrued interest receivables written off by reversing interest income by major security type.

### **Question 24.3.100** What disclosures are required about an entity's elections related to accrued interest receivable?

**Interpretive response:** There are four elections an entity can make related to the measurement, presentation and disclosure of accrued interest receivable associated with AFS debt securities. The following table lists the disclosure requirement for each election.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

| Election | Disclosure requirement |
|---|---|
| Present accrued interest receivable separately from the associated AFS debt security (see Question 23.3.10) | Disclose the amount of accrued interest, net of the allowance for credit losses (if any), and the line item in which that amount is presented. [326-30-50-3A] |
| Exclude the accrued interest receivable that is included in the instrument's amortized cost basis from the disclosure requirements in paragraphs 326-30-50-4 to 50-10 (see Question 24.2.20) | Disclose the total amount of excluded accrued interest (net) from the disclosed amortized cost basis. [326-30-50-3B] |
| Not to measure an allowance for credit losses for accrued interest receivable if the entity:<br>• excludes accrued interest receivable from both fair value and amortized cost when identifying impairment; and<br>• writes off accrued interest receivable in a timely manner.<br>(see section 19.4.30) | Disclose that accounting policy election, including information about what time periods are considered timely (at the major security-type level). [326-30-50-3C] |
| To write off accrued interest receivable by reversing interest income, recognizing credit loss expense, or a combination of both (see Question 19.6.30) | Disclose the elected accounting policy and – if applicable – the amount written off by reversing interest income, by major security type. [326-30-50-3D] |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# 25. Effective dates and transition**

## Detailed contents

**25.1 How the standard works**

**25.2 Effective dates and transition provisions for ASU 2025-05**

**Questions**

**Question 25.2.10** When does an entity adopt ASU 2025-05?

**Question 25.2.20** What are ASU 2025-05's transition provisions in the year of adoption?

**Question 25.2.30** Must an entity perform a preferability assessment if it elects ASU 2025-05's simplifications after the effective date?

**25.3 Effective dates and transition provisions for ASU 2025-08**

**Questions**

**Question 25.3.10** When is an entity required to adopt ASU 2025-08?

**Question 25.3.20** Can an entity early adopt ASU 2025-08?

**Question 25.3.30** What are ASU 2025-08's transition provisions in the year of adoption?

**Question 25.3.40** Is an SEC registrant that early adopts ASU 2025-08's PSL guidance in a quarterly period other than its first quarterly period required to file an amended Form 10-Q for previously filed quarters?

**Example**

**Example 25.3.10** ASU 2025-08 effective date and transition

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 25.1 How the standard works

### *ASU 2025-05*

The other chapters of this Handbook assume that an entity has adopted ASU 2025-05, Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets. This chapter discusses the effective dates and transition guidance for applying ASU 2025-05.

The following table summarizes the effective dates for ASU 2025-05.

| | |
|---|---|
| **Effective date:** | **All entities:** Annual and interim periods in fiscal years beginning after December 15, 2025. |
| **Early adoption:** | Available for financial statements that have not yet been issued or made available for issuance. |

### *ASU 2025-08*

The other chapters of this Handbook assume that an entity has adopted ASU 2025-08, Financial Instruments – Credit Losses (Topic 326): Purchased Loans. This chapter discusses the effective dates and transition guidance for applying ASU 2025-08.

The following table summarizes the effective dates for ASU 2025-08.

| | |
|---|---|
| **Effective date:** | **All entities:** Annual and interim periods in fiscal years beginning after December 15, 2026. |
| **Early adoption:** | Available for financial statements that have not yet been issued or made available for issuance. |

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 25.2 Effective dates and transition provisions for ASU 2025-05

### Excerpt from ASC 326-10

> Transition Related to Accounting Standards Update No. 2025-05, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets*

**65-6** The following represents the transition and effective date information related to Accounting Standards Update No. 2025-05, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets*:

**Effective date and early adoption**

a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2025, and interim reporting periods within those annual reporting periods.
b. Early adoption of the pending content that links to this paragraph is permitted in both interim and annual reporting periods in which financial statements have not yet been issued or made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim reporting period, it shall apply the pending content as of the beginning of the annual reporting period that includes that interim reporting period.

**Transition method**

c. An entity shall apply the pending content that links to this paragraph prospectively to estimates of expected credit losses on asset balances described in paragraph 326-20-30-10A performed after the date of adoption.
d. An entity other than a public business entity that elects the practical expedient and, if applicable, the accounting policy election after the effective date would not need to perform a preferability assessment in accordance with paragraph 250-10-45-2.

### **Question 25.2.10** When does an entity adopt ASU 2025-05?

**Interpretive response:** All entities are required to adopt ASU 2025-05 for annual and interim periods in fiscal years beginning after December 15, 2025 (e.g. January 1, 2026 for calendar year-end entities). [326-20-65-6(a)]

Additionally, an entity is permitted to early adopt ASU 2025-05 in interim and annual periods for financial statements not yet issued or available for issuance. If an entity elects to early adopt in an interim period, the guidance must be applied as of the beginning of the annual reporting period that includes that interim period. [326-20-65-6(b)]

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### **Question 25.2.20** What are ASU 2025-05's transition provisions in the year of adoption?

**Interpretive response:** The amendments are applied prospectively to estimates of expected credit losses performed after the adoption date (i.e. those performed after the beginning of the annual reporting period in which the ASU is adopted). [326-20-65-6(c)].

### **Question 25.2.30** Must an entity perform a preferability assessment if it elects ASU 2025-05's simplifications after the effective date?

**Interpretive response:** It depends on whether the entity is a PBE. An entity that is not a PBE that elects ASU 2025-05's simplifications related to current accounts receivable and current contract assets (see section 10.4) after the effective date is not required to perform a preferability assessment. However, the FASB did not provide a similar transition provision for PBEs. [326-20-65-6(d), ASU 2025-05.BC47]

## 25.3 Effective dates and transition provisions for ASU 2025-08

### Excerpt from ASC 326-10

> Transition Related to Accounting Standards Update No. 2025-08, *Financial Instruments—Credit Losses (Topic 326): Purchased Loans*

**65-7** The following represents the transition and effective date information related to Accounting Standards Update No. 2025-08, *Financial Instruments—Credit Losses (Topic 326): Purchased Loans*:

**Effective date and early adoption**

a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after December 15, 2026, and interim reporting periods within those annual reporting periods.
b. Early adoption of the pending content that links to this paragraph is permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. If an entity adopts the pending content that links to this paragraph in an interim reporting period, it shall apply the pending content as of the beginning of that interim reporting period or the beginning of the annual reporting period that includes that interim reporting period.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Transition method**

c. An entity shall apply the pending content that links to this paragraph prospectively to loans that are acquired on or after the date of initial application of the pending content.

## **Question 25.3.10** When is an entity required to adopt ASU 2025-08?

**Interpretive response:** All entities are required to adopt ASU 2025-08 for annual and interim periods in fiscal years beginning after December 15, 2026 (e.g. January 1, 2027 for calendar year-end entities). [326-10-65-7(a)]

## **Question 25.3.20** Can an entity early adopt ASU 2025-08?

**Interpretive response:** Yes, early adoption is permitted in any annual or interim reporting period for which financial statements have not yet been issued or made available for issuance. [326-10-65-7(b)]

If an entity early adopts in an interim period, it elects to apply the amendments as of a date referred to as the 'initial application date', which is the date at the beginning of either of the following two periods: [326-10-65-7(b)]

- the interim reporting period; or
- the annual reporting period that includes the interim period.

## **Question 25.3.30** What are ASU 2025-08's transition provisions in the year of adoption?

**Interpretive response:** The amendments are applied prospectively to loans that are acquired on or after the initial application date. [326-10-65-7(c)]

## **Question 25.3.40** Is an SEC registrant that early adopts ASU 2025-08's PSL guidance in a quarterly period other than its first quarterly period required to file an amended Form 10-Q for previously filed quarters?

**Interpretive response:** Generally, no. Because the SEC registrant was applying US GAAP that was effective for the previously filed interim period financial statements, that information was not in error. As a result, we believe an SEC registrant generally is not required to file an amended Form 10-Q for previously filed quarters. However, in certain circumstances the information for previous quarterly reporting periods will need to be restated when it is included in

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

subsequent SEC filings. The following are two instances in which such a restatement or amendment may (or will) be necessary.

- When the SEC registrant subsequently files a 1933 Act registration statement, we believe it should consider consulting with SEC staff, securities counsel and/or its auditors to determine whether previously filed interim period financial information should be amended to reflect the restated financial information (e.g. through filing a Form 8-K).
- When the SEC registrant subsequently makes its quarterly and annual filings, it restates the quarterly information included to reflect adoption of the ASU as of the beginning of the year of adoption. This includes revising the quarterly information in subsequent interim period filings as comparative financial information or when it is included in Form 10-K. For example, an SEC registrant includes quarterly information in Form 10-K when it is required under Regulation S-K Item 302(a), Disclosure of material quarterly changes.

## **Example 25.3.10** ASU 2025-08 effective date and transition

Bank is a calendar-year end entity and had two business combinations in 2026 that were accounted for using the acquisition method: one in February 2026 and the other in November 2026. Certain loans acquired in the business combination would be PSLs under the guidance in ASU 2025-08.

***Scenario 1: Bank early adopts ASU 2025-08 during 2026***

Bank early adopts ASU 2025-08 in the fourth quarter of 2026 (i.e. an interim period), so it is required to apply the new guidance prospectively from the initial application date. Bank may elect either of the following dates as the initial application date:

- January 1, 2026 (i.e. the beginning of the annual reporting period that includes the interim period): in this situation, the PSL guidance would be applied to both business combinations; or
- October 1, 2026 (i.e. the beginning of the interim reporting period): in this situation, the PSL guidance would only be applied to the November business combination.

***Scenario 2: Bank does not early adopt ASU 2025-08***

Bank does not early adopt ASU 2025-08, so it applies the PSL guidance prospectively to any acquired loans that meet the PSL definition starting on January 1, 2027. Therefore, it does not apply the PSL guidance to either of the 2026 business combinations.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# Index of changes

This index lists the significant additions and changes made in this edition to assist you in locating recently added or updated content. The following symbols are used throughout this Handbook to indicate the types of revisions made in this edition for sections, Questions, Examples and other items:

** new item
# significant updates or revisions to the item

**1. Executive summary**

Simplified guidance for current accounts receivable and contract assets**

Purchased financial assets – credit deteriorated assets and purchased seasoned loans#

**7. Historical loss experience, forecasts and reversion**

**Question**

**Question 7.3.15** Must an entity consider multiple economic scenarios when developing its economic forecast?#

**Example**

**Example 7.3.05** Multiple vs single scenario approaches for economic forecasts#

**10. Practical expedients and simplifications**

10.1 How the standard works

Current accounts receivable and contract assets (section 10.4)**

10.4 Current accounts receivable and contract assets**

*[All content in this section is new.]*

**12. Purchased financial assets**

12.1 How the standard works#

12.2.10 PCD assets#

12.2.20 Purchased seasoned loans (PSLs)**

*[All content in this section is new.]*

12.3.10 Overview#

12.4.10 Overview#

12.4.20 Expected recoveries of PCD assets#

12.5.10 Overview#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

### Questions

**Question 12.3.10** What is the effect of using the gross-up method for PCD assets and PSLs?#

**Question 12.3.40** May the initial estimate of the allowance for credit losses for PCD assets and PSLs vary based on the method used?#

**Question 12.3.50** How does an entity initially estimate expected credit losses for PCD assets and PSLs if a discounted cash flow method is not used?#

**Question 12.4.10** For PCD assets and PSLs, does an entity have to maintain the method used to initially estimate expected credit losses for subsequent measurement?**

**Question 12.4.20** Must an entity maintain the integrity of a pool of PCD assets or PSLs?#

**Question 12.5.10** Does an entity recognize the non-credit discount for PCD assets and PSLs at a pool level?#

**Question 12.5.20** May a PCD asset or PSL be placed on nonaccrual status?#

## 12A. Business combinations and asset acquisitions

12A.1 How the standard works#

12A.2 Scope and initial measurement#

### Questions

**Question 12A.2.60** Do the PCD asset and PSL accounting models apply to assets acquired in a business combination?#

**Question 12A.2.80** Do the PCD asset and PSL accounting models apply to off-balance sheet credit exposures assumed in a business combination?#

**Question 12A.2.90** If pushdown accounting is elected, is PCD asset and PSL accounting at the parent level pushed down in the stand-alone financial statements of the acquiree?#

**Question 12A.3.10** During the measurement period, can an acquirer reevaluate and change assets to which PCD asset accounting or PSL accounting is applied?#

**Question 12A.3.20** How are measurement period adjustments related to PCD assets accounted for?#

### Examples

**Example 12A.2.30** Acquisition of bank with assets that are not PCD#

**Example 12A.3.10** Applying the measurement period guidance to purchased financial assets#

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## 13. Off-balance sheet credit exposures

### Questions

**Question 13.2.20** Is a forward commitment to purchase loans in the scope of Subtopic 326-20?#

**Question 13.3.60** How does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans?#

**Question 13.3.70** When does an entity recognize and measure the liability for off-balance sheet credit exposure on a forward commitment to purchase loans that have not been specifically identified?#

### Example

**Example 13.3.50** Forward commitment to purchase loans that are not PCD and not PSLs#

## 18. Specific considerations for commercial entities and trade receivables

18.3.10 Overview#

18.4.10 Overview#

### Question

**Question 18.3.10** Can an entity use an aging schedule to estimate its allowance for credit losses for short-term trade receivables?#

### Example

**Example 18.4.10** Acquisition of a company with trade receivables#

## 20. Beneficial interests

### Question

**Question 20.4.20** How is the effective interest rate recalculated when an adverse change in expected cash flows is not reflected as an increase in the allowance?#

## 24. Disclosures

24.2.85 Simplifications for current accounts receivable and contract assets**

*[All content in this section is new.]*

### Question

**Question 24.2.150** What disclosures are required about the roll-forward of the allowance for credit losses?#

## 25. Effective dates and transition**

*[All content in this chapter is new.]*

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

# KPMG Financial Reporting View

Delivering guidance and insights, KPMG Financial Reporting View is ready to inform your decision making. Stay up to date with us.

### Defining Issues

Our collection of newsletters with insights and news about financial reporting and regulatory developments, including Quarterly Outlook and FRV Weekly.

### Handbooks and Hot Topics

Our discussion and analysis of accounting topics – from short Hot Topics that deal with a topical issue, to our in-depth guides covering a broad area of accounting.

### CPE opportunities

Register for live discussions of topical accounting and financial reporting issues. CPE-eligible replays also available.

### Financial Reporting Podcasts

Tune in to hear KPMG professionals discuss major accounting and financial reporting developments.

Visit **Financial Reporting View**
and **sign up** for news and insights

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

## Access our US Handbooks

As part of Financial Reporting View, our library of in-depth guidance can be accessed here, including the following Handbooks.

- Accounting changes and error corrections
- Accounting for economic disruption
- Asset acquisitions
- Bankruptcies
- Business combinations
- Business combinations (SEC reporting)
- California climate laws
- Climate risk in the financial statements
- Consolidation
- Contingencies, commitments and guarantees
- Credit impairment
- Crypto assets
- Debt and equity financing
- Derivatives and hedging
- Discontinued operations and held-for-sale disposal groups
- Earnings per share
- Employee benefits
- Equity method of accounting
- Fair value measurement
- Financial statement presentation
- Foreign currency
- GHG emissions reporting
- Going concern
- IFRS® compared to US GAAP
- Impairment of nonfinancial assets
- Income taxes
- Internal control over financial reporting
- Inventory
- Investment companies
- Investments
- Leases
- Long-duration contracts
- Non-GAAP financial measures
- Research and development
- Revenue recognition
- Revenue: Real estate
- Revenue: Software and SaaS
- Segment reporting
- Service concession arrangements
- Share-based payment
- Software and website costs
- Statement of cash flows
- Tax credits
- Transfers and servicing of financial assets

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

**Learn about us:** **kpmg.com**

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2026 KPMG LLP, a Delaware limited liability partnership, and its subsidiaries are part of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

The *FASB Accounting Standards Codification*® and other FASB content are copyrighted by the Financial Accounting Foundation, Norwalk, Connecticut, and are used with permission.