

FASB Issues Guidance on Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses

The FASB issued ASU 2010-20: Receivables (Topic 310) – *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses* on July 21, 2010. The ASU's main objective is to provide financial statement users with greater transparency about an entity's allowance for credit losses and the credit quality of its financing receivables. The ASU amends current guidance and will require significant additional disclosures in an entity's financial statements, including the requirement to provide a greater level of disaggregated data, as it relates to exposure to credit losses.

The ASU also expands the definition of a financing receivable to include a contractual right to receive money either on demand or on fixed or determinable dates, that is recognized as an asset on the entity's statement of financial position. This includes trade accounts receivable (although trade receivables not exceeding one year that arose from the sale of goods or services are exempt from certain disclosures), loans, loan syndications, factoring arrangements, and standby

letters of credit. Therefore, this guidance will affect not only the financial institutions, but other industries and entity types (such as lessors), as well as entities that have accounts receivable exceeding one year or notes receivable. There are several types of instruments scoped out of this guidance, including debt securities and receivables measured at fair value or the lower of cost of market, such as mortgage loans held for sale.

While the ASU will have the greatest impact on financial institutions, it applies to all entities, including AI's Hardware Store who has converted some of its accounts receivable to notes receivable in order to help out struggling customers.

Disclosure Requirements

An entity will be required to provide disclosures that facilitate financial statement users' evaluation of the following:

1. The nature of credit risk inherent in the entity's portfolio of financing receivables,
2. How that risk is analyzed and assessed in arriving at the allowance for credit losses, and
3. The changes and reasons for those changes in the allowance for credit losses.

In order to achieve the objective described above, the FASB determined that an entity should provide disclosures on financing receivables and the related allowance for credit losses on a disaggregated basis. The ASU defines two levels of disaggregation—**portfolio segment** and **class of financing receivable**. A **portfolio segment** is defined as the level at which an entity develops and documents a systematic method for determining its allowance for credit losses. **Classes of financing receivables** generally are a disaggregation of portfolio segment, determined on the basis of their initial measurement attribute, risk characteristics, and method for monitoring and assessing credit risk.

Under the new guidance, new disclosures required to be presented by **portfolio segment** include:

- Rollforward of the allowance for credit losses, including ending balance further disaggregated based on impairment methodology
- Balances of financing receivables
- Purchases and sales of financing receivables

New disclosures required to be presented by **class of financing receivables** include:

- Aging of past dues at the end of the reporting period
- Credit quality indicators at the end of the reporting period
- Nonaccrual status of financing receivables
- Impaired financing receivables
- Information regarding troubled debt restructurings

In addition, an entity will also be required to disclose the quantitative effect of changes in accounting policies or methodology of its allowance for credit losses on the current period provision.

The brief summary above provides information relating to the more significant changes of this new guidance. The ASU provides additional details, including illustrative examples for many of the new required disclosures. It is noted that the new disclosure requirements will require significant additional data gathering, and entities should start preparing now in order to comply.

Effective Date

For **public entities**, the disclosures as of the end of a reporting period are effective for the first interim or annual reporting period ending on or after December 15, 2010. The disclosures about activity that occurs during a reporting period are effective for the first interim or annual reporting period beginning on or after December 15, 2010. For **nonpublic entities**, the disclosures are effective for the first annual reporting period ending on or after December 15, 2011. The ASU encourages, but does not require, comparative disclosures for earlier reporting periods that ended before initial adoption. However, an entity should provide comparative disclosures for those reporting periods ending after initial adoption.

About Dixon Hughes: *Dixon Hughes is the largest accounting firm based in the Southern U.S. and ranks among the nation's top 20. With a staff of over 1200 located in eight states, the firm provides a wide array of assurance, tax and consulting services to clients of all sizes. For more information, visit www.dixon-hughes.com.*