



Article

MAY 2019

By Scott Dietz

## Reporting and CECL: A Seismic Shift for Accountants

From an accounting standpoint, the changes in how to account for credit-loss reserves within the banking, insurance, and lending industries stemming from the Financial Accounting Standards Board's (FASB) current expected credit losses (CECL) guidance [1] are significant. From an implementation perspective, what has not received enough attention yet are the reporting and disclosure implications. It is important that these new requirements be considered at the start of implementation work, not just at completion.

What makes CECL disclosure requirements so challenging is not just the sheer number of requirements detailed within the standard. For most organizations, this type of detailed reporting on their allowance numbers will be completely new. The allowance has always been a significant estimate but it was rarely attributed to individual assets and was therefore only presented in broad, statement-level reports.

With CECL, the number and granularity of the required disclosures will make it difficult not to maintain the allowance at an instrument level. An example is disclosures that will require vintage year of origination or changes in the allowance by specific activity, in order to roll forward the balance. To create these reports, one must have granular results and cannot use a simple portfolio-level balance. This adds challenges throughout the allowance process, requiring testing and assurances that data attributes are accurate and that instrument-level allocations have been performed appropriately and can withstand the challenges of audits and exams.

Another obstacle is that not all entities will be analyzing their allowance results in the same way as the reporting requirements are dictating. For example, to comply with the vintage analysis disclosure, an entity will have to display the allowance by credit quality indicator as well as vintage. While there is some flexibility in what credit indicator is used, the vintage requirement does not offer any flexibility in how it is applied. This poses concern for some entities if they are not considering vintage as one of the key drivers in their allowance, and thus changes in the allowance may be difficult to explain when viewed through this report.

CECL reporting requirements are also going to cause accountants to have to shift some of their thinking going forward. Accounting estimates have always required disclosures and detail about how estimates

were determined; traditionally, accountants have not been required to attribute period-over-period changes in estimates to specific drivers. As a result, they focused on just one or two overarching factors to explain these changes. This is no longer sufficient since granular attributions are required by the new standard to complete the roll-forward disclosures.

Certain aspects of this analysis—new purchases, sales, charge-offs—will be relatively straightforward. The effects of other factors such as model changes, the passage of time, and recoveries, are harder to isolate. Industry practitioners have already proposed recommended disclosure frameworks. Regardless of which method is used, the roll-forward must allow stakeholders to understand the drivers of portfolio change at a level of detail to which accountants may not be accustomed. This challenge only increases when the effects of exams and audits are considered in the development of these reports.

The challenges are clear in the context of these quantitative disclosures, but the qualitative disclosure requirements will prove similarly challenging. Here the difficulty will not relate to the ability to accurately disclose a breakdown of the overall reserve estimate, but the ability to explain the context around it and even consider potential future changes. For example, while the roll-forward reporting noted in the previous paragraphs may show that new purchases drove a significant change in the balance, it will be within the qualitative discussion that stakeholders will want to understand the details of the new purchase, and whether this was a strategy of the company or an unexpected outcome. Specifically, FASB requires that the disclosures provide the ability to “understand the circumstances that caused changes” and include discussions about “past events” and “current conditions” that caused changes in the allowance.

Furthermore, consider that CECL requires the allowance itself to consider past, current, and future (as far as lifetime) projections at determination. If changes are occurring in any of these conditions it will require discussion. The requirement to consider future events in one's allowance leads to a need to include changes in forecasted data in the qualitative disclosures. Incorporating this data into financial statement footnotes adds another hurdle to these requirements as it will again cause accountants and auditors to publically disclose detail they are not accustomed to.

As the timeline for CECL compliance shortens it is vital that companies start asking themselves just how will they be able to manage external appetite for sufficient, comprehensive, and compliant CECL disclosures. All eyes will be on public business entities who will be among the first to file CECL-compliant financial statements in 2020—and some questions may be cleared up then—but regardless, the time to start planning for these challenges is now.

## Appendix:

Below is a listing of the required disclosures that are outlined within the CECL standard, including those for available-for-sale debt securities. It is important to note that these requirements do not include the significant changes that will result to regulatory, SEC, or MD&A reporting within financial statements.

### [1]ASU 2016-13 Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments

#### LIST OF REQUIRED DISCLOSURES OUTLINED WITHIN THE CECL STANDARD

Disclosure	Guidance Reference	Required Classifications	Required for non-PBE	Financing Receivables	HTM Debt Securities	AFS Debt Securities
1 Qualitative Disclosures	ASU 326-20-50-10 ASU 326-20-50-11		Yes	✓	✓	✓
2 Attribution Analysis	ASU 326-20-50-13	• Portfolio segment • Major security type	Yes	✓	✓	
3 Rollforward for Allowance of Credit Losses	ASU 326-20-50-13 ASU 326-20-50-12	• Portfolio segment • Major security type	Yes	✓	✓	
4 Rollforward for Allowance of Credit Losses – AFS Securities	ASU 326-30-50-9	• Major security type	Yes			✓
5 AFS securities in Unrealized Loss Position for which Allowance for Credit Losses has not been recorded	ASU 326-30-50-4	• Major security type	Yes			✓
6 Purchased Financial Assets with Credit Deterioration (PCD)	ASU 326-20-50-19 ASU 326-30-50-10	• Major security type	Yes	✓	✓	✓
7 Amortized Cost by Credit Quality Indicator	ASU 326-20-50-5	• Portfolio segment • Major security type	Yes		✓	✓
8 Amortized Cost by Credit Quality Indicator – by Vintage	ASU 326-20-50-5 ASU 326-20-50-6	• Vintage • Portfolio segment • Major security type	Yes (vintage classification is not required for non-PBE)	✓		
9 Past Due Status	ASU 326-20-50-14	• Class of financing receivable • Major security type	Yes	✓	✓	
10 Non Accrual Status	ASU 326-20-50-16	• Class of financing receivable • Major security type	Yes	✓	✓	
11 Trouble Debt Restructurings	ASU 310-10-55-33 ASU 310-10-55-34	• Class of financing receivable	Yes	✓		
12 Unfunded Commitments on Troubled Debt Restructurings	ASU 310-40-50-1	• Class of financing receivable	Yes	✓		
13 Collateral Dependent Financial Assets	ASU 326-20-50-20	• Class of financing receivable • Major security type	Yes	✓	✓	✓
14 Securities Gains and Losses	ASU 320-10-50-2 ASU 320-10-50-5	• Major security type	Yes		✓	✓
15 Securities by Maturity	ASU 320-10-50-3 ASU 320-10-50-5	• Major security type	Yes		✓	✓

## AUTHORS



Scott Dietz

**Director, Regulatory and Accounting Solutions**

Scott is a Director in the Regulatory and Accounting Solutions team responsible for providing accounting expertise across solutions, products, and services offered by Moody's Analytics in the US. He has over 15 years of experience leading auditing, consulting and accounting policy initiatives for financial institutions.

© 2018 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND MOODY'S PUBLICATIONS MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER.

ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY ANY PERSON AS A BENCHMARK AS THAT TERM IS DEFINED FOR REGULATORY PURPOSES AND MUST NOT BE USED IN ANY WAY THAT COULD RESULT IN THEM BEING CONSIDERED A BENCHMARK.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at [www.moody.com](http://www.moody.com) under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.