Article

MAY 2019

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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.

<u>Appendix:</u>

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 Discloures	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

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