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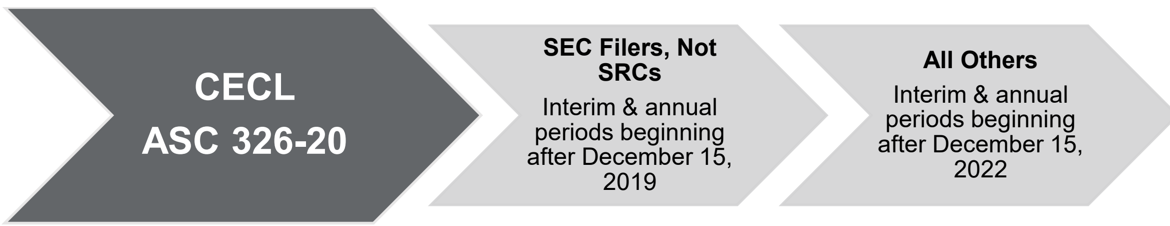
All Companies & NFPs Could Be Impacted by CECL

FASB's new credit impairment rules in Accounting Standards Codification (ASC) 326, Financial Instruments—Credit Losses, became effective for many SEC filers in 2020. However, for all other companies, they are effective for fiscal years beginning after December 15, 2022. That means January 1, 2023 for all those that have not yet adopted and have a calendar year-end. While the biggest impact is on financial institutions holding loans and debt securities, all companies and nonprofit (NFP) organizations will be affected as the guidance's scope also covers trade receivables, among other financial assets. Some changes for receivables are subtle, and long-dated receivables will be subject to new disclosure.



Scope

Includes:

- Financing receivables
- Held-to-maturity debt
- Receivables that result from revenue transactions
- Receivables on repurchase and securities lending agreements
- Net investments in leases recognized by lessors
- Loan commitments, guarantees, standby letters of credit
- Lease receivables
- Reinsurance recoverables

Excludes:

- Financial assets at fair value
- Available-for-sale debt (although there is an updated model ASC 326-30 with similar concepts)
- Participant loans made by defined contribution benefit plans
- Insurance policy loans
- NFP pledges receivables
- Receivables arising from operating leases

When Is a Loss Recognized?

The new requirements are known as the current expected credit loss (CECL) model. Under current U.S. GAAP for receivables, a loss must be incurred or probable and reasonably estimated to be recorded. However, the CECL model does not specify a threshold or trigger for the recognition of an impairment allowance. The loss to be recognized as an allowance is as of the inception of the receivable and reflects the current expectation for all future losses. An expectation of no losses is generally not reasonable under the guidance.

How Is a Loss Calculated?

At inception and each reporting date, entities will recognize an allowance for lifetime expected credit losses for instruments within the scope of ASC 326-20. Credit losses reflect the estimated contractual cash flows not expected to be collected over the receivable’s contractual term and are immediately recognized through net income. Amounts deemed uncollectible will be written off in a manner consistent with existing U.S. GAAP. Entities have flexibility to develop methods to estimate and measure expected credit losses as long as the methods are consistently applied and reflect the CECL model’s key elements.

Current U.S. GAAP	CECL Model
Amount of probable loss based on events that have occurred to the measurement date	Current estimate of lifetime cash flows not expected to be collected discounted at the effective rate

What Information Is Used to Determine a Loss?

FASB has broadened the information an entity is required to consider in developing its credit loss estimate. Under current GAAP, an entity usually only considers past events and current conditions. ASC 326-20 requires the loss estimate to include relevant information about past events, current conditions,

and reasonable and supportable forecasts. An entity only needs to consider information that is reasonably available without undue cost and effort, and can use both internal and external information for credit loss estimates. After the forecasted period, entities should revert to historical credit loss experience. An entity may immediately revert to historical loss information or converge to historical losses using a rational and systematic basis.

Entities must develop credit loss estimates on a pooled basis if the assets share similar risk characteristics. Pooling for credit loss measurement should be consistent with the entity's policies for monitoring credit risk. The guidance provides examples of risk characteristics that might be used to pool assets, such as geographic location, age, term, industry, internal or external credit score or ratings, or size. Receivables that do not share risk characteristics should be assessed for credit losses on an individual basis.

As noted above, the CECL model does not have a threshold or trigger for credit loss recognition; therefore, companies will need to measure expected credit losses on all trade receivables, even those with a low risk of loss.

New Disclosures

CECL requires new disclosures related to how management monitors credit quality and assesses credit risk. Many existing disclosures have been carried forward, *e.g.*, how expected loss estimates are developed, the accounting policies and methodology used to estimate the allowance for expected credit losses, and any policy or methodology changes from the prior period and reasons for significant write-offs. Under CECL, entities also will be required to discuss the method of reversion to historical credit loss experience for periods beyond which the entity is unable to make or obtain reasonable and supportable forecasts.

In addition, for long-dated trade receivables, entities will be required to provide quantitative and qualitative information by class of financing receivable and include a description of the credit quality indicator. Entities using internal-risk ratings must provide qualitative information on how those ratings relate to the likelihood of loss. Trade receivables due in one year or less are exempt from disclosing credit quality indicators.

Upcoming Effective Date

Public business entities that are SEC filers (other than smaller reporting entities) and banks that did not avail themselves of certain statutory deferrals have already adopted the CECL model. The effective date for all other entities, including private and NFP entities, is for fiscal years beginning after December 15, 2022, including interim financial statements. That date is fast approaching!

Conclusion

The adoption of the CECL model will be complex and likely will require significant hours to implement correctly. **FORVIS** can help educate your team, provide implementation tools, and assist with analysis and documentation. If you would like assistance in complying with the CECL standard, contact a professional at FORVIS. FORVIS has prepared a library of **FORsights**™ on this topic. Visit our website to learn more.

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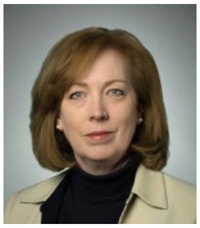

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