What is CECL and Who Does It Apply To?

What is CECL? The Financial Accounting Standards Board (FASB) announced in 2016 a new accounting standard introducing the Current Estimate of Credit Losses, or CECL, methodology for estimating allowances for credit losses. The new methodology for estimating expected credit losses is intended to simplify loss recognition by allowing one standard method for estimating future losses which includes a more consistent definition of when a future loss is 'probable'.

Who needs to perform a CECL estimate? FASB is phasing in the CECL requirement, beginning with publicly traded companies.

Publicly traded companies – 2023, end of year filings with the SEC must include a CECL compliant loss estimate. Auditors will review methods for estimating losses to ensure compliance with the new CECL standards. See SEC rules and taxonomy here.

Mid-Sized businesses – no legal requirement exists as yet for mid-sized businesses to file CECL compliant loss estimate models. However, businesses with lines of credit may be subject to more stringent requirements for estimating impairments to trade receivables and other assets.

Small businesses – no CECL requirement is scheduled in the near term for independently financed businesses.

Why is the CECL loss estimate initiative considered a good business practice? A businesses A/R portfolio can be its single largest asset. From this asset, the businesses cash flows are derived. Any impairment to the underlying value of the A/R asset can materialize as a financial loss in the future. What a CECL loss estimate model does is it requires a potential A/R loss to be recognized earlier than it otherwise would have been. This protects the financial well being of the business, and any lenders to that business.

ACCOUNTING STANDARDS UPDATE 2016-13, *FINANCIAL INSTRUMENTS—CREDIT LOSSES (TOPIC 326)*

Overview

On June 16, 2016, the FASB completed its Financial Instruments—Credit Losses project by issuing Accounting Standards Update No. 2016-13, *Financial Instruments—Credit Losses (Topic 326)*. The new guidance requires organizations to measure all expected credit losses for financial instruments held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts.

To that end, the new guidance:

1. Eliminates the probable initial recognition threshold in current GAAP and, instead, reflects an organization's current estimate of all expected credit losses over the contractual term of its financial assets
2. Broadens the information that an entity can consider when measuring credit losses to include forward-looking information
3. Increases usefulness of the financial statements by requiring timely inclusion of forecasted information in forming expectations of credit losses
4. Increases comparability of purchased financial assets with credit deterioration (PCD assets) with other purchased assets that do not have credit deterioration as well as originated assets because credit losses that are expected will be recorded through an allowance for credit losses for all assets
5. Increases users' understanding of underwriting standards and credit quality trends by requiring additional information about credit quality indicators by year of origination (vintage)
6. For available-for-sale debt securities, aligns the income statement recognition of credit losses with the reporting period in which changes occur by recording credit losses (and subsequent changes in credit losses) through an allowance rather than a write down

The new guidance affects organizations that hold financial assets and net investments in leases that are not accounted for at fair value with changes in fair value reported in net income.

The new guidance affects loans, debt securities, trade receivables, net investments in leases, off-balance-sheet credit exposures, reinsurance receivables, and any other financial assets not excluded from the scope that have the contractual right to receive cash.

Effective Dates

The effective dates for Update 2016-13 are as follows:

1. Public business entities that meet the definition of an U.S. Securities and Exchange (SEC) filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years
2. All other entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years.

Early application is permitted.

Additional Information

- Download the **Accounting Standards Update**
- Read the **Press Release** introducing the ASU

To Learn More

- Read the **FASB In Focus**—a summary of the ASU
- Read the **FASB: Understanding Costs and Benefits**
- Watch ***Why a New Credit Losses Standard?***—a video featuring FASB Chair Russ Golden and FASB Members Hal Schroeder and Marc Siegel

Post-Issuance Activities

- Read the **FASB Staff Q&A No. 1**—Whether the Weighted-Average Remaining Maturity Method Is an Acceptable Method to Estimate Expected Credit Losses
- Read the **FASB Staff Q&A No. 2**—Developing an Estimate of Expected Credit Losses on Financial Assets
- Learn more about upcoming **CECL workshops**
- Visit the **Transition Resource Group for Credit Losses webpage** to stay up to date on implementation issues discussed and addressed by the TRG.

Have A Question?

Submit questions about the new requirements using our Technical Inquiry System.

History of the FASB CECL initiative, see here, includes updates since the original proposal released in 2016.

Additional Reading:

Federal Reserve - FAQ New Accounting Standards

Deloitte - good practical guidance for public companies

US Dept of Treasury – CECL supervision and bank examination insights

St. Louis Fed – supervisory guidelines and insights

Visit Educate To Career – CECL Programs and Information to create a CECL compliant loss estimate model