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CECL guidebook

Part 1

An introduction to the FASB financial instruments credit loss model

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Background

In June 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-13, Financial Instruments – Credit Losses, the second of three standards the FASB issued as part of its financial instruments accounting project. The first standard, ASU 2016-01, Financial Instruments – Overall, addresses recognition and measurement of financial instruments and was issued in January 2016.

The third standard, addressing issues related to hedge accounting for financial instruments, was issued in the August 2017. The result of the credit loss standard is the creation of a new topic within the codification, Topic 326, which includes two subtopics. The first relates to financial assets that are measured at amortized cost, and the second relates to available-for-sale debt securities.

This guide will provide an overview of the new rules. For a more in-depth look at specific topics, please also see our CECL guides on loss rate calculations, adjustments for current conditions and reasonable and supportable forecasts, disclosures, and internal control over financial reporting.

Major changes

While there are some modifications to available-for-sale debt securities and purchased credit-impaired assets that will impact financial institutions, the big change in the amendments of ASU 2016-13 is the replacement of the incurred loss impairment method used in existing generally accepted accounting principles (GAAP) with a current expected credit losses (CECL) model for financial assets carried at amortized cost. This area of the new standard broadens the information that an institution must consider in developing its expected credit loss estimate, including reasonable and supportable forecasted information. The new credit loss model will generally call for immediate recognition of all expected credit losses, whereas previous GAAP generally delayed the recognition of the full amount of credit losses until the loss was probable.



PLANTE MORAN PERSPECTIVE

CECL is arguably the largest change in accounting for financial institutions in the last 30 years and will have widespread implications for the industry. Financial institutions will need to be intentional in their planning for adoption and should begin now to:

- ✓ Ensure sufficient resources are available.
- ✓ Identify the methodology to be used for the calculation.
- ✓ Develop a timeline for implementation.
- ✓ Begin to gather relevant data.

When considering the appropriate methodology, financial institutions should keep in mind the amendments in ASU 2016-13 provide several methods that vary in complexity, but federal regulators have made it clear that small institutions can do without complex models.

Early adoption is an option for every institution. One benefit is that it allows entities to build reserves in advance of a potential economic downturn.

Effective dates

The new standard is effective for SEC filers who are not smaller reporting companies for fiscal years beginning after Dec. 15, 2019. For all other entities, the standard is effective for fiscal years beginning after Dec. 15, 2022. The new standard will require the cumulative effect of the change to be recorded to retained earnings for financial assets measured at amortized cost while the changes for available-for-sale debt securities and purchased credit deteriorated assets generally will be considered prospectively.



Financial assets measured at amortized cost and on leases

ASU 2016-13 changes the objectives included in previous GAAP, which generally delayed the recognition of the full amount of credit losses until the loss was probable. The new credit loss model will generally call for immediate recognition of all expected credit losses over the contractual life of the asset. It does so by broadening the information that an institution must consider as it develops its expected credit loss estimate to include life-of-asset-concepts as well as reasonable and supportable forecasted information that impacts the portfolio. All financial assets measured at amortized cost will be impacted. The most common assets at financial institutions that will be impacted will be loans, held-to-maturity investment securities, and leases. This section of the guide will focus on the impact on loans since this will be the most prevalent change for community institutions.



PLANTE MORAN PERSPECTIVE

The standard provides a great deal of flexibility regarding methods to measure the expected credit losses. However, significant judgment will be required on the front end of adoption to develop a methodology with the appropriate level of complexity for each community institution.

Due to lifetime allowances being recorded on Day One of originating a loan, we would expect provisions for credit losses in periods of origination to represent the majority of the provision necessary. Accordingly, we expect that any provisions to credit loss subsequent to the period of origination of that loan will fine tune the original estimate. Therefore, the provision for credit losses each period could be directly correlated with the level of originations of loans during that same period.

Measurement: The starting point

SELECTING A METHODOLOGY

The standard provides several methodologies that can be employed in measuring the current expected credit losses. The complexity of these methodologies varies and should be commensurate with that of each institution. These methodologies are listed in ascending order of complexity:

- ✓ **Average charge-off method**
This method is straightforward and is most similar to loss rate models used at many smaller, less complex institutions under the incurred loss rules. The average charge-off method calculates an estimate of losses with a high level of emphasis on historical experience.
- ✓ **Static pool analysis**
The static pool method is easily confused with the vintage analysis. The static pool analysis is based on pools of financial assets that have similar risk characteristics and originated within a similar period of time.

✓ **Vintage analysis.**

The vintage analysis is heavily based on the age of the financial asset. Financial assets with similar age are pooled together based on similar risk characteristics, and the use of loss curves or other patterns are typically utilized in forecasting estimated credit losses.

✓ **Migration analysis or the “roll-rate” method.**

A migration analysis considers the likelihood that a financial asset will move toward default. This method looks to predict the estimate of credit losses for a pool of financial assets by utilizing delinquency or risk grade experience and trends.

✓ **Discounted cash flow analysis.**

This method is currently widely used but isn't required by this new standard¹. The discounted cash flow method considers the amount and timing of expected cash flows that are then discounted at the loan's effective interest rate².

✓ **Probability-of-default method.**

This model requires an institution to assess the probability that an asset will default. Furthermore, this method quantifies the potential loss exposure and provides an estimate of the loss given default.

✓ **Regression analysis.**

In this complex method, the estimate of credit losses is based on many independent variables that are input into a statistical calculation.

¹ The discounted cash flow methodology isn't required unless measuring the economic concession for a troubled debt restructuring (TDR). When using the discounted cash flow methodology, the credit loss is measured as the amount in which the amortized cost basis of the loan is greater than the discounted cash flows.

² The effective interest rate is generally an asset's contractual interest rate, adjusted for net deferred fees or costs, premium, or discount. For variable rate loans, the effective interest rate changes as the contractual rate changes. There is no requirement to project future changes in variable rates, but ASU 2019-04 permits institutions to project future cash flows based on projected changes in rates (except for TDRs). If this accounting policy election is made, the effective interest rate used to discount cash flows should be adjusted as well. Additionally, any projected changes in prepayments based on the projected change in rates would be incorporated into the cash flow estimates.



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Referencing the FASB's "Small banks do not need complex models" guidance, we believe the size of the institution and the complexity of the portfolio should be commensurate with the methodology. As a result, average charge-off, static pool, and vintage analysis will likely be the most widely used and accepted methodologies for community financial institutions. Many community institutions who used spreadsheets to calculate an allowance under the incurred loss rules have transitioned to a "snapshot" method that incorporates many of the same inputs as their incurred loss calculation. However, we encourage each institution to be prudent and diligent in selecting its methodology, through discussions with both its external auditors and regulators.



For detailed example calculations, please see our guidebook on loss rate calculations.

POOL IDENTIFICATION AND MANAGEMENT

Under this new standard, expected credit losses will be measured on a pooled basis. Financial assets will need to be analyzed for similar risk characteristics and combined into a pool when at least one common risk characteristic exists. The standard sets forth criteria that should be used in assessing risk characteristics, including:

- ✓ Vintage³
- ✓ Asset type
- ✓ Collateral type
- ✓ Size of asset
- ✓ Internal/External credit score
- ✓ Effective interest rate
- ✓ Risk rating/classification
- ✓ Term
- ✓ Geography
- ✓ Industry
- ✓ Historical/Expected credit loss
- ✓ Reasonable & supportable forecasts

This standard requires that disclosures be at a level that an institution uses to determine its allowance for credit losses. We believe that understanding the level of detail that must be disclosed is relevant.

³ Vintage may impact segmentation, disclosure, and certain allowance for credit loss calculation methodologies. For vintage purposes, CECL did not amend the guidance for determining whether a loan is a new loan. ASC 310-20 indicates if terms of a refinancing or restructuring (other than a TDR) are at least as favorable to the lender as terms for comparable loans to other customers with similar collection risks who are not refinancing or restructuring, the loan should be accounted for as a new loan. Institutions should consider the magnitude of refinancing and restructuring, as well as the impact on segmentation, disclosure, and calculation. Processes and controls may need to be implemented to ensure proper determination of whether a refinancing or restructuring qualifies as a new loan.



SEGMENT:

Level at which an institution develops and documents a systematic methodology to determine its allowance for credit losses. Specific examples in the standard include the type of loan, industry sector of the borrower, and risk rating.

CLASS:

Disaggregated segments determined on the basis of:

- ✓ Risk characteristics
- ✓ The institution's method for monitoring and assessing credit risk
- ✓ Concentrations

As further described in our separate guidebook of CECL disclosures, the first disclosure to consider is loan vintage or year of origination. The standard requires public business entities (PBEs)⁴ to state the vintage of loans within their disclosures. Due to industry pushback, the FASB removed the disclosure requirement for non-PBEs.

The remaining disclosures must be disaggregated by either the portfolio segment or class, further defined by the standard as follows:

- ✓ Subsequent to a pool of loans being formed, a loan can be moved to another pool if risk characteristics change. Additionally, if a borrower has evidence of financial difficulty and doesn't have similar risk characteristics as other loans, a loan can be evaluated for expected credit losses individually and, thus, removed from the collective allowance.



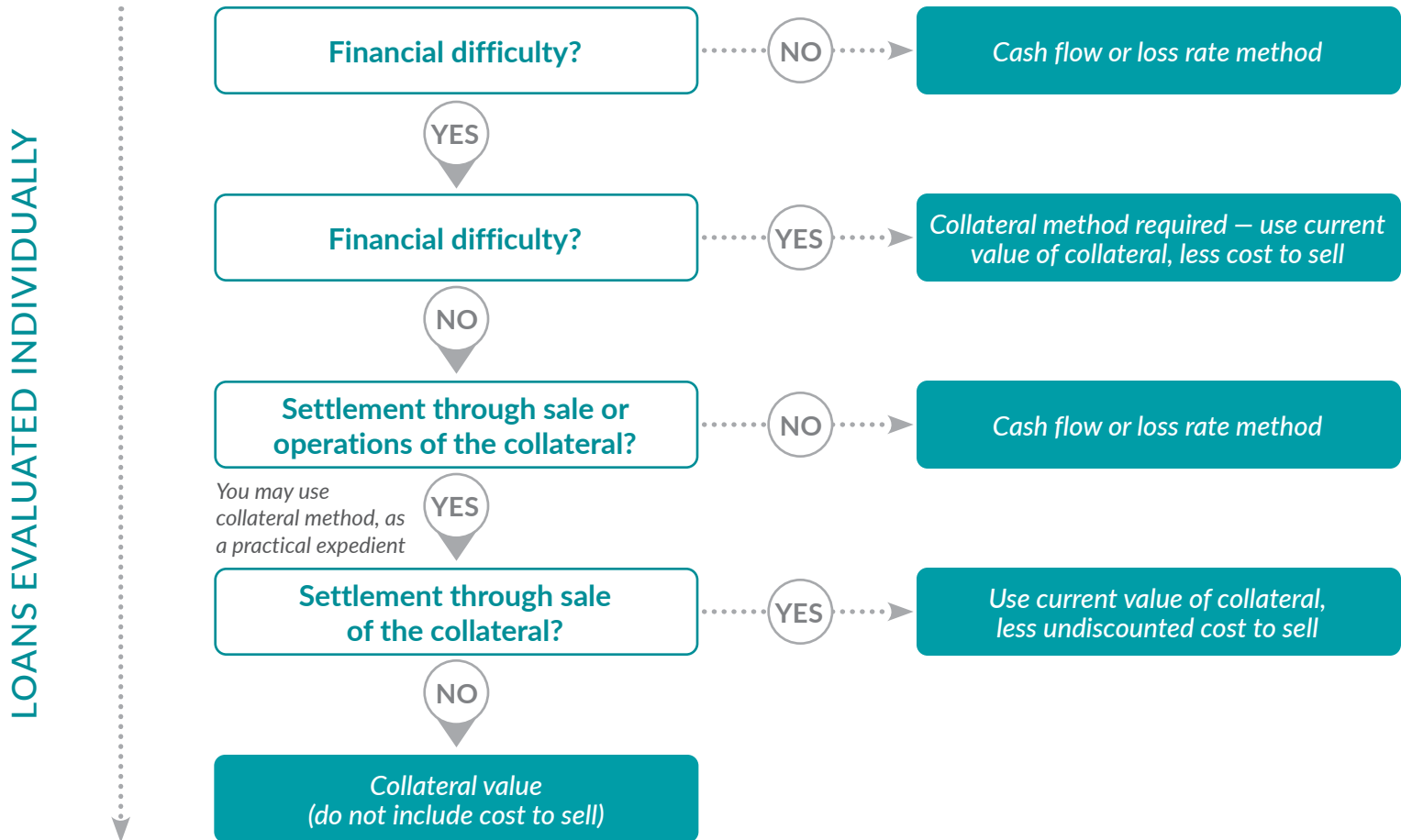
PLANTE MORAN PERSPECTIVE

The identification of loan pools is a key item to consider because it will be the basis for the allowance calculation for years to follow. Accordingly, we encourage financial institutions to review their current processes and systems to avoid creating unnecessary administrative burdens.

⁴Institutions should verify PBE status since entities may be considered PBEs as defined by the FASB (ASU 2013-12) even if they aren't U.S. SEC registrants.

Individually evaluating loans

The concept of loan impairment has been struck from the accounting literature. While there are no specific requirements regarding loan inclusions or exclusions, we believe individually evaluated loans would primarily be due to risk classification or delinquency status. The following flowchart can assist in determining your method for evaluating credit losses:



Data aggregation

The level of data for implementation of this new standard by community institutions will be enhanced from what is utilized today for many institutions and will be necessary to achieve pooling. The accumulation of loan data and the verification of its accuracy should be a priority in the early stages of implementation. While the number of necessary items in this list could vary from each institution, the table below provides a list of items that we believe are relevant for tracking.

Segment identifier	Class identifier	Borrower name
Borrower location	Collateral location	Gross charge offs to date
Origination date	Loan type	Gross recoveries to date
Renewal date	Current balance	Account number
Maturity date	Origination balance	Variable rate index
Amortization period	Original collateral value	Most current collateral value
Interest rate (fixed vs. variable)	Date of original collateral value	Date of most current collateral value
Lien position	Key collateral value inputs (capitalization rate)	Collateral type
Original risk rating	Debt service coverage ratio	Days past due
Current risk rating	Credit scores	Unfunded commitments
Date of risk rating change	Exception to loan policy indicator	SIC or NAIC codes

In addition to loan level data, institutions will need to gather external economic data on a national, regional, or local basis where available. The purpose of this data is to adjust the historical loss information to current conditions and to support reasonable and supportable forecasts. For example, understanding real estate value trends over an extended period of time could help estimate peaks and troughs of business cycles and related losses. This data would include not only real estate value trends but also factors such as unemployment, disposable income, consumer price index, and gross domestic product. Excellent sources for this data are the various publications issued by the Federal Reserve, Office of the Comptroller of the Currency, and the Federal Deposit Insurance Corp.

There are limited circumstances in which a loan or pool of loans would not require an allowance for credit loss. If the historical credit loss information adjusted for current conditions and reasonable and supportable forecasts results in an expectation that no loss exists, no allowance may be appropriate. However, the standard indicates that this assessment cannot be based on collateral value alone but must also consider the nature of the collateral, potential future changes in its value, and historical loss information for loans with similar collateral.

Off-balance sheet exposures are also within the scope of this topic and would require a liability to be recorded for unfunded obligations⁵. It's important to note that this liability would be for contractual obligations that aren't unconditionally cancelable by the institution. Thus, an institution would be required to consider the likelihood of funding and record a liability for credit loss through credit loss expense.

The estimate of expected credit losses applied to loans needs to include factors over the life of the loan, which starts with the full contractual term of the loan and requires certain assumptions. First, the contractual term of the loan wouldn't be extended for expected renewals, extensions, or modifications unless a troubled debt restructuring is reasonably expected on an individual basis. Second, prepayments should be factored into the estimate and can be considered as either a separate input or embedded in the historical loss information. Lastly, credit enhancements such as the financial condition of a guarantor and its willingness to pay, or whether any subordinated interests are able to absorb the losses would also be factored into the estimate of credit losses. We believe including credit enhancements in the loss estimate would require a high degree of verifiable documentation since they're highly subjective.



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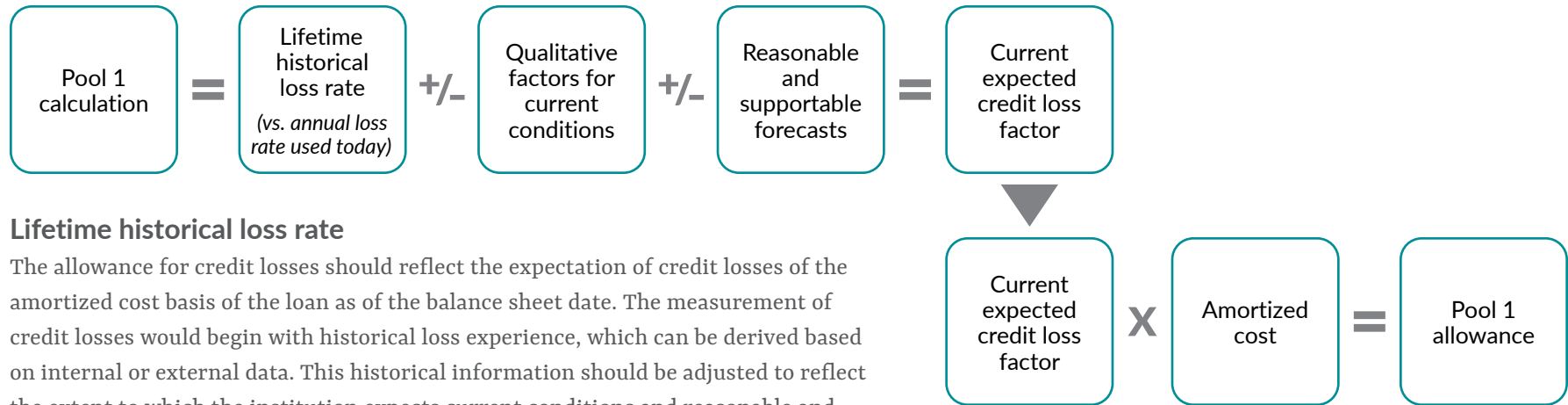
The contractual term used in estimating credit losses is extended if an institution has a reasonable expectation that a troubled debt restructuring will be executed with a given borrower. To comply with this requirement, we recommend institutions establish a threshold at which management will indicate whether a TDR is expected for individual loans, such as all commercial loans of a certain risk rating or all retail loans of a certain delinquency status. This exercise could be incorporated into the periodic review of the institution's watchlist. De minimis thresholds could be established to avoid performing this analysis on loans or pools where the impact would be trivial. Note the expectation of executing a TDR is made on an individual loan basis. Therefore, it's not necessary to forecast the portion of performing loans which will eventually become TDRs based on an institution's historical experience in executing them.

⁵ The August 2019 Bank Accounting Advisory Series from the Office of the Comptroller of the Currency has indicated unfunded commitments associated with a HELOC generally would not meet the accounting definition of "unconditionally cancellable," as Regulation Z prohibits institutions from refusing to extend credit without cause.

Key concepts for calculation

THE CALCULATION

The final standard provides several examples for calculating the allowance for credit losses that include the basic mathematical concept to be utilized.



Lifetime historical loss rate

The allowance for credit losses should reflect the expectation of credit losses of the amortized cost basis of the loan as of the balance sheet date. The measurement of credit losses would begin with historical loss experience, which can be derived based on internal or external data. This historical information should be adjusted to reflect the extent to which the institution expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period in which the historical information was derived.



PLANTE MORAN PERSPECTIVE

Keep this concept in mind as you consider the calculation: The standard provides for flexibility and judgment to be applied by each financial institution but is clear that an allowance for credit loss should be made even when remote. It further indicates that the measurement of the allowance should consider all relevant information but also explicitly indicates that an institution isn't required to search all possible information not reasonably available without undue cost and effort. The effectiveness of these assumptions is likely to be a point of discussion during the implementation period and first years of application due to the low threshold for "remote" and the likely differing interpretations of "not reasonably available without undue cost and effort."

Qualitative factors for current conditions

As the calculation cannot rely solely on past events, adjustments to the historical loss information are likely to be made to account for differences in current and specific risk characteristics within the pool at the reporting date such as economic environment, underwriting differences, asset mix, or contractual term.

Reasonable and supportable forecasts

The most difficult concept for the industry to understand is that related to implementing reasonable and supportable forecasts. These forecasts aren't required to be for the full contractual term of the loan but still provide for an area of significant judgment with a high level of documentation required. For example, if an institution has a loan backed by real estate and prices are declining, it could base a forecast of additional loss by looking at long-term trends to estimate the trough of the downturn.

An institution can't always forecast reasonably for the full contractual term. In these circumstances, the standard requires an institution to revert to the unadjusted historical loss rate to contractual maturity. The reversion can be done several ways including at the input level or based on the entire estimate and may revert immediately, on straight line, or another rational and systematic basis.

Disclosures by financing receivable and major security type

ASU 2016-13 provides changes to the credit quality disclosures previously required but, for the most part, the disclosures remain very similar. The standard supersedes the current disclosures for credit quality, the allowance, past due, nonaccrual, purchased credit deteriorated, collateral dependent financial assets, and off-balance sheet exposures. An institution will need to strike a balance between providing the appropriate amount of detailed disclosure in a financial statement and overburdening it with excessive detail.



For more information on forecasting, including illustrative examples and our team's perspectives, please see our guidebook on applying the current condition and reasonable and supportable forecasts.



For more information on disclosures, including illustrative examples and our team's perspectives, please see our guidebook on CECL disclosures.



Purchased financial assets with credit deterioration (PCD)

Over the last several years, the industry has seen a significant number of mergers and acquisitions that resulted in cumbersome accounting being applied to acquired financial assets. The modifications to the current accounting standards in ASU 2016-13 provide a welcome change to the complexity but also lower the threshold at which an asset would qualify as a PCD asset.

Under the new standard, the scope to qualify for a PCD asset is an assessment by the acquirer at acquisition to determine whether each asset has experienced a “more than insignificant” amount of deterioration in credit quality since origination. This threshold is lower than the “significant” deterioration requirement previously applied. Factors including collateral coverage, credit rating, and debt-service coverage ratios could indicate deteriorated credit. While an institution will be required to identify all PCD assets at acquisition, we expect the focus for classification determination to be on those assets that are delinquent, downgraded, or are nonaccrual.

The accounting for PCD assets requires an allocation of a credit discount⁶ and noncredit discount/premium at the time of acquisition. The noncredit discount/ premium is accreted/amortized into interest income over the life of the asset. The credit discount component is presented as an allowance, and there is no accretion prospectively. The standard provides flexibility in the recognition of income through accrual, cash basis, or cost recovery method and doesn't prohibit the use of a nonaccrual designation. However, the recognition of interest income is dependent upon having a reasonable expectation about the amount expected to be collected.

Non-PCD assets are recorded at fair value on Day One with an allowance for credit losses recorded through earnings. Previously, an allowance for performing loans would only be recorded subsequently when acquired loans went bad. The discount on non-PCD loans isn't split between a credit and noncredit component, but inherently does incorporate credit risk. Many analysts have referred to this as double counting the credit risk because it's accounted for in the fair value mark and allowance for credit losses.

⁶ The credit discount would be presented on the acquirer's balance sheet as an allowance for credit loss, which is a change from current guidance. This change will allow for greater comparability of the allowance for credit loss to total loans ratio that is highly utilized throughout the industry.



Available-for-sale debt securities

Overview

ASU 2016-13 makes some positive changes to the other-than-temporary impairment guidance. The prior guidance caused a new cost basis to be established when loss was recorded associated with other-than-temporary impairment, with no chance of recovery unless the asset was sold. Under this new standard, an allowance will be established to capture estimated credit losses on individually identified available-for-sale debt securities and can fluctuate up or down as circumstances change with a security. We believe this to be a positive change from the current accounting standards that do not allow for reversals of other than temporary impairment recorded through earnings as a security improves.

Identifying and accounting for credit loss

When measuring the allowance for an individual security, there are several items to consider in determining whether a potential credit loss exists. These factors include items such as the length of time a security has been in an unrealized loss position, the extent to which the security is under water, the ability of issuer to make payments in the future (including payments that would increase due to changes in credit ratings), current financial condition of the issuer, and changes in the credit characteristics of the underlying instruments of the security.

ESTIMATING CASH FLOWS

If a financial institution's assessment determines there is a possibility of credit loss, the institution would be required to perform a discounted cash flow analysis to measure the allowance for credit loss. In forming the assumptions for the estimate of expected cash flows, the institution should include all of the following:

- ✓ *Pre-payments*
- ✓ *Value of any underlying collateral*
- ✓ *Remaining payment terms*
- ✓ *Expected defaults*
- ✓ *Financial condition of the issuer*

Further, the standard requires that the information utilized to develop the assumptions for the estimate of expected cash flows should include information not only about past events but also current conditions and reasonable and supportable forecasts. To achieve this forward-looking perspective for estimated expected cash flows, institutions should consider the following:

- ✓ *Credit ratings*
- ✓ *Analyst reports & forecasts*
- ✓ *Other relevant market data*
- ✓ *Credit enhancements*
 - » *Guarantor support & willingness of guarantor to meet its obligations*
 - » *Ability of subordinated interests to absorb losses*
- ✓ *Changes in payment terms, including increased payments on variable rate instruments & balloon payment & their impact on performance of the security*
- ✓ *Current estimate of collateral value & its impact on the performance of the security*

In considering all these inputs related to the institution's best estimate of expected cash flows, the institution should use judgment in concluding upon the use of certain inputs. Accordingly, the more a given assumption can be verified, the more weight it should receive in selecting inputs to utilize.

DISCOUNT RATE

Once the estimate of expected cash flows is determined, the rate implicit in the security will be utilized to discount the cash flows. ASU 2019-04 permits an institution to make an accounting policy election to adjust the effective interest rate used to discount expected future cash flows for expected prepayments on available-for-sale securities to appropriately isolate credit risk in determining the allowance for credit losses. For variable rate securities, the discount rate may be fixed at the effective rate when impairment was identified, or the rate may be adjusted to the actual one in effect as it changes over the life of the security.

Measurement and subsequent accounting

To measure the allowance established on available-for-sale debt securities, the result of the discounted cash flows will be compared to the amortized cost basis of the security on a regular basis. If the amortized cost basis is greater than the discounted cash flows, the difference will be recorded as an allowance through credit loss expense. However, the allowance will be limited to the unrealized loss of the security. Any future changes to the allowance will be reflected in the income statement with either additional credit loss expense or expense reversal.

In circumstances where an institution has the intention to sell or, more likely than not, must sell a security with an allowance, the allowance will be written off. The result of this transaction is a new cost basis for the security, and the asset would not be written back up if fair value recovers. Accordingly, any increase in fair value is recorded in other comprehensive income. The difference between the new cost basis and expected cash flows to be collected is then accreted into income, and any future recoveries received are recorded through the allowance.

Beneficial interests

The standard provides guidance for certain beneficial interests that provide rights to receive all or a portion of specified cash inflows received by a trust and passed through to an investor. These beneficial interests are those that have all the following characteristics:

- ✓ *Are debt securities required to be accounted for as such*
- ✓ *Involve securitized financial assets that have contractual cash flows (e.g. loans)*
- ✓ *Do not result in consolidation of the entity issuing the beneficial interest*
- ✓ *Are not beneficial interests in securitized financial assets that have both of the following elements:*
 - » *Are of high credit quality (e.g., guaranteed by U.S. government or its agencies)*
 - » *Cannot contractually be prepaid or otherwise settled in such a way that the holder wouldn't recover substantially all of its recorded investment*

An example of these instruments for community institutions would have been the trust preferred securities that were much more common prior to the most recent financial crisis. However, should institutions have instruments that would qualify, the following are key concepts of which to be aware:

- ✓ *An entity should account for credit losses on beneficial interests for held-to-maturity & available-for-sale securities*
- ✓ *Present value of cash flow method required for beneficial interests*
- ✓ *Changes in interest rates of a plain-vanilla, variable rate interest generally wouldn't require an allowance*
- ✓ *Inappropriate to automatically conclude no credit loss because all payments have been received*
- ✓ *Inappropriate to automatically conclude every decline in fair value represents credit loss*

The end result of having these beneficial interests is the expectation for a higher level of documentation and analysis to support the valuation of the security.

Disclosures

As discussed in greater detail in our guidebook on CECL disclosures, disclosure requirements for credit losses on available-for-sale debt securities were only slightly modified with this new standard. We believe that the disclosures for most community institutions would remain relatively similar to the way they are today. While some disclosure requirements exist for unrealized losses without an allowance, we believe these disclosures would be scalable based upon the materiality of unrealized losses to an individual security and financial statements as a whole.



Effective date and transition

The FASB has provided a long runway for adoption due to the amount of preparation necessary.

Effective dates

The new standard is effective for U.S. Securities and Exchange Commission (SEC) filers who aren't smaller reporting companies as defined by the SEC for fiscal years beginning after Dec. 15, 2019⁷. For all other entities, the standard is effective for fiscal years beginning after Dec. 15, 2022. The one-time determination of whether an entity is a smaller reporting company is based on its most recent determination as of Nov. 15, 2019. The table below provides key adoption dates for annual reporting, interim SEC filings and call reports.

ADOPTION	SEC REGISTRANTS, EXCLUDING SMALLER REPORTING COMPANIES	ALL OTHER ENTITIES
Fiscal years beginning after Dec. 15	2019	2022
Interim periods beginning	2020	2023
Period for calendar year ends	March 31, 2020	March 31, 2023
Period for June 30 year ends	Sept. 30, 2020	Sept. 30, 2023

The effect of the standard is measured on Day One in the year of adoption or January 1 for calendar year organizations. Early adoption of this new standard is allowed for fiscal years beginning after Dec. 15, 2018, including interim periods within those fiscal years.

⁷ The Coronavirus Aid, Relief, and Economic Security (CARES) Act provided the option for a temporary delay in implementation by insured depository institutions until the earlier of Dec. 31, 2020, or the date on which the national emergency related to the COVID-19 outbreak is terminated. The SEC Office of the Chief Accountant indicated the SEC staff would not object to eligible institutions electing to take advantage of this delay.

Transition guidance

The cumulative impact of adopting this new standard will not impact current year earnings. Instead, a cumulative-effect adjustment will be made to the opening retained earnings as of the beginning of the first reporting period in which the standard is effective. Disclosures in the year of adoption would include the nature of the change in accounting principle, method of applying the change, and effect of any line item in the balance sheet, except subtotals, if material.

A new concept believed to be one of the most important by the FASB is vintage. Accordingly, the FASB adjusted the disclosure requirements to include disclosure of vintage for financial assets measured at amortized cost. Due to industry pushback, the FASB removed the disclosure requirement for non-PBEs and provided a phase-in approach for PBEs. The year of adoption for PBEs should include three years of vintage with each subsequent year being added to the disclosure until five years are disclosed.

The standard provides transition guidance for those institutions that have recorded other-than-temporary impairment on securities prior to the adoption of the standard. This guidance specifies that neither adjustment to the cost basis nor the effective interest rate should be made at adoption, and amounts in accumulated other comprehensive income that relate to improvements in cash flows are to be accreted into income over the life of the security on a level-yield basis. Should these securities receive recoveries on amounts written off after adoption, the amounts received would be recorded to income.

For beneficial interests and purchased financial assets with credit deterioration (PCD assets) acquired prior to adoption, these are key concepts of which to be aware:

- ✓ *PCD asset classification does not need to be reassessed*
- ✓ *A reclassification adjustment will be made to establish an allowance for credit losses*
- ✓ *After reclassification of the allowance, the remaining noncredit discount or premium will be accreted or amortized into interest income using the interest method and effective interest rate at the date of adoption.*



Plante Moran is here to help

Many institutions adopted the new standard in 2020. We recognize the significant amount of uncertainty and anxiety felt by institutions adopting in 2023. While preparation should start sooner rather than later, we assure you that the road to implementation can be pragmatic and streamlined. We have provided the following suggested timeline for these institutions.

By YE 2020

- Begin education
- Begin dialogue with regulators & auditors
- Evaluate resources
- Understand methodologies allowed
- Develop a timeline for implementation



By Q2 2021

- Select methodology
- Identify pools
- Verify current data accuracy
- Gather data
- Establish processes & controls
- Initiate model validation



By Q4 2021

- Verify new activity
- Perform shadow calculation
- Test controls
- Begin training/corrections
- Execute model validation



By YE 2022

- Incorporate results of model validation
- Measure impact as of Jan. 1, 2023 for calendar year-end companies



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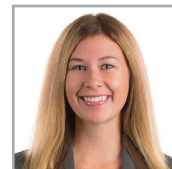
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