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The Current Expected Credit Loss (CECL) Model—Are You Ready?

Background

On June 16, 2016, the FASB issued Accounting Standards Update (ASU) 2016-13, *Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.* The amendments in this ASU significantly change how entities will measure credit losses for most financial assets and certain other instruments that aren't measured at fair value through net income. In our August 2016 report, we focused on the impact of ASU 2016-13 on trade receivables. Since many of our members have financial institution clients, in this report, we will focus on the "current expected credit loss" (CECL) model and its impact on accounting for loan losses by financial institutions.

Practice Note: The impact on accounting for loan losses by financial institutions could have a significant impact for non-financial institutions. A survey of 26 financial institution executives of different sizes by Moody's Analytics indicated that 31% believed CECL would impact loan pricing. Only 19% indicated CECL would not impact loan pricing. The remainder were answered "Unsure/N/A".

Accounting for loan losses is fundamental to bank accounting; it affects what banks do—lend money and collect principal and interest. Current U.S. generally accepted accounting principles (U.S. GAAP) contains an "incurred loss" methodology for recognizing credit losses. This methodology delays recognition until it is probable a loss has been incurred. For practical purposes, that impairment is normally measured in pools of loans and is heavily based on historic annualized charge-off rates (adjusted for certain qualitative considerations/factors). In other words, current charge-off ratios, probabilities of default, loss given default, and rates based on past due status are based on yearly charge-offs.

In contrast, CECL has an "expected loss" notion which expands the recorded loss estimate to not only include losses that have been incurred but also those that have not occurred but can be expected in the future. Further, the historical data that CECL relies

upon is not annual loss rates, but is instead life of loan or life of portfolio loss rates. Rates based on activity during specific time periods (such as one year), would not satisfy the life of loan loss expectation requirement. In other words, where incurred loss accounting essentially reflects the current *losses* in a portfolio, CECL reflects the current *risk* in the portfolio, which includes both current and future credit losses.

Under CECL, amounts that banks do not expect to collect will be recorded in the allowance for loan and lease losses (ALLL) and in an allowance for credit losses on held-to-maturity (HTM) debt securities. Any additions to the ALLL are recorded as expenses, which reduces a bank's capital.

As noted above, this report focuses on CECL and its impact on accounting for loan losses by financial institutions. As such, the new standard applies to any entity holding financial assets and net investments in leases which includes all banks, savings associations, credit unions, and financial institution holding companies (hereafter, institutions), regardless of size, that file regulatory reports for which the reporting requirements conform to U.S. GAAP.

***Practice Note**:* Until the new standard becomes effective, institutions must continue to follow current U.S. GAAP on impairment and the ALLL along with the related supervisory guidance on the ALLL. It is not appropriate to begin increasing allowance levels beyond those appropriate under existing U.S. GAAP in advance of CECL's effective date. When estimating allowance levels before CECL's effective date, the implementation of the CECL methodology is a future event. It is, therefore, inappropriate to treat CECL as a basis for qualitatively adjusting allowances measured under the existing incurred loss methodology.

Effective Date

The effective date applicable to an institution depends on the institution's characteristics. For a public business entity (PBE) that is a Security and Exchange Commission (SEC) filer, the new standard is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Accordingly, for a calendar-year SEC filer, the standard is effective January 1, 2020, and it must first apply the standard in its financial statements and regulatory reports (e.g., the Call Report) for the quarter ended March 31, 2020.

For a PBE that is not an SEC filer, the standard is effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Therefore, for a calendar-year PBE that is not an SEC filer, the standard is effective January 1, 2021, and the entity must first apply the new credit losses standard in its financial statements and regulatory reports for the quarter ended March 31, 2021.

CPEA Observation: A bank with over $500 million in assets required to file annual audited financial statements with the FDIC and financial statements that are available upon request would be considered a PBE, if it has one or more securities not subject to contractual restrictions on transfer. These restrictions may be contained in buy-sell, shareholder, or other agreements.

For an entity that is not a PBE, the standard is effective for fiscal years beginning after December 15, 2020, and for interim period financial statements for fiscal years beginning after December 15, 2021. Consequently, a calendar-year entity that is not a PBE must first apply the standard in its financial statements and regulatory reports for December 31, 2021. However, such an institution would include the CECL provision for expected credit losses for the entire year ended December 31, 2021, in the income statement in its financial statements and regulatory reports for year-end 2021.

Early application will be permitted for all organizations for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018.

CPEA Practice Note: If a calendar-year bank that is not a PBE does not early adopt ASU 2016-13 for its quarterly reporting in the year of adoption (calendar 2021), the amounts reported quarterly will be inconsistent with the year-end audited financial statements because they have been calculated using different methods.

<u>Key Changes Required by CECL</u>

The CECL model is designed to capture all contractual cash flows not expected to be collected. In addition, it encompasses a “life of loan” (LOL) concept and removes the threshold of probable loss for recognition. Other key differences from the current loss methodology include the following:

- Day one loss recognition—an allowance will be created upon origination or acquisition of a financial asset; the allowance will then be updated at subsequent reporting dates. As a result, according to a survey by Moody’s Analytics, 62% of financial institutions expect to increase their ALLL upon adoption of CECL.
- Collective measurement—CECL requires credit losses to be evaluated on a collective basis when similar credit risk characteristics exist; loans that do not have similar risk characteristics to other loans are evaluated on an individual basis.
- Risk pools—existing methods of grouping loans by Fed call code and risk rating will not be sufficient for CECL; instead, term, prepayments, loss accumulation periods, risk rating changes, vintage, and other risk characteristics will need to be considered.
- Reversion—CECL does allow entities to revert to historical loss information for periods beyond which the institution is unable to make or obtain reasonable and

supportable forecasts of expected credit losses; reversion to historical loss information may be at the input level or based on the entire estimate and may occur immediately, on a straight-line basis, or using another rational and systematic basis.

- Purchased credit deteriorated loans (PCD)—allowance for expected credit losses on PCD loans is recorded as a gross-up to the purchased loans.
- Troubled debt restructurings (TDRs)—CECL requires the value of concession made by the creditor to be recorded through the allowance for credit losses; impairment is no longer required to be measured using specific methods (e.g., discounted cash flow or fair value of collateral).
- Off-balance-sheet credit exposures—commitments to extend credit, guarantees, and standby letters of credit that are not considered derivatives under ASC 815, *Derivatives and Hedging*, are subject to credit risk and are therefore within the scope of CECL. Accordingly, an institution will estimate expected credit losses over the contractual period in which they are exposed to credit risk, unless it is unconditionally cancelable by the issuer; in this case, no credit loss is recorded.

Estimation Methods

Impairment measurement under existing U.S. GAAP has often been considered complex because it encompasses five credit impairment models for different financial assets. CECL, on the other hand, introduces a single measurement objective to be applied to all financial assets carried at amortized cost, including loans held for investment (HFI) and HTM debt securities. However, CECL does not specify a single method for measuring expected credit losses; rather, it allows any reasonable approach, as long as the estimate of expected credit losses achieves the objective of the new accounting standard. Under today's incurred loss methodology, institutions use various methods, including historical loss rate methods, roll-rate methods, and discounted cash flow methods, to estimate credit losses. CECL allows the continued use of any of these methods; however, certain changes will be needed in order to estimate lifetime expected credit losses. Specifically, CECL will require a change from today's incurred loss model to an expected credit loss model, which is a lifetime estimate. Because of that fundamental change, institutions will have to develop estimates that are clearly more forward-looking than they were in the past. For instance, the inputs to a loss rate method would need to reflect expected losses over the contractual term, rather than the annual loss rates commonly used under the existing incurred loss methodology.

Historical loss information generally provides a basis for an institution's assessment of expected credit losses but may not fully reflect expectations about the future. Institutions will need to consider how to adjust historical loss experience not only for current conditions, as is required under the existing incurred loss methodology, but also for

reasonable and supportable forecasts that affect the expected collectability of financial assets. The adjustments shall reflect significant factors impacting expected collectibility. Examples of factors an institution might consider, depending on the nature of the asset, include the following:

- The borrower's financial condition, credit rating, credit score, asset quality or business prospects
- The borrower's ability to make scheduled interest or principal payments
- The remaining payment terms of the financial asset(s)
- The remaining time to maturity and the timing and extent of prepayments on the financial asset(s)
- The nature and volume of the institution's financial asset(s)
- The volume and severity of past due financial asset(s) and the volume and severity of adversely classified or rated financial asset(s)
- The value of underlying collateral on financial assets in which the collateral-dependent practical expedient has not been used
- The institution's lending policies and procedures, including changes in underwriting standards, collection and write-off and recovery practices, as well as knowledge of the borrower's operations or the borrower's standing in the community
- The quality of the institution's credit review system
- The experience, ability and depth of the entity's management, lending staff and other relevant staff
- The environmental factors of a borrower, and the areas where the institution's credit is concentrated, such as:
    - Regulatory, legal or technological environment to which the entity has exposure
    - Changes and expected changes in the general market condition of either the geographical area or the industry to which the institution has exposure
    - Changes and expected changes in international, national, regional and local economic and business conditions and developments in which the institution operates, including the condition and expected condition of various market segments

Nevertheless, taking these factors into account, banking regulators have asserted that smaller and less complex institutions should be able to adjust their existing allowance methods to meet the requirements of the new accounting standard without the use of costly and/or complex modeling techniques.

Practice Note*:* The first criteria in determining the appropriate credit loss measurement method is how it conforms to the bank's credit and risk analysis processes. The amount

of “expected loss” in a portfolio should be driven by that credit analysis and not merely a calculation made to comply with U.S. GAAP.

Institutions will have to change their methodology (by either modifying their existing methodology or making a wholesale change in methodology) to implement CECL. However, the models do not need to be unnecessarily complex, and only relevant factors to the underlying financial assets should be used. Institutions might need to re-evaluate the current primary drivers of loss when revising their methodologies. While it’s likely more than one driver of expected losses exists for each portfolio, factors that do not demonstrate a correlation with expected losses should not be incorporated.

***Practice Note**:* While institutions may use existing risk management practices or systems to develop this forward-looking estimate, many of those systems may not have been subjected to financial statement and internal control audits, and entities should consider this as they develop a plan to implement the CECL model.

CPEA Observation: An institution may apply different estimation methods to different groups of financial assets.

***Practice Note**:* Although other methodologies may be more appropriate as a basis for the ALLL estimate, because vintage analysis allows for review of loan activity from the beginning of the life of the loan (origination) to the end (pay-off or charge-off), it will likely be part of the analysis. Also, vintage analysis will likely be needed by auditors in order to identify “loss curve” patterns and to evaluate exposures that may result from changing underwriting standards or the progression of an economic cycle. This would be a major change from current practice and, while it may not always involve unmanageable complexity, it could dramatically increase the amount of work required. For example, an ALLL estimate for a portfolio of loans with an expected life of four years will necessitate four different ALLL estimates—one for each vintage. When applying a forecast of the future over four years, since loans are likely to behave differently based on their age, calculations not only for each vintage may be necessary, but separate estimates addressing each vintage by loan age in each future year may be necessary. As a result, for a portfolio with an expected life of four years, ten different sub-calculations would be needed for practical purposes. See the following example, adapted from the American Bankers Association.

Vintage Analysis Example

The percentages below represent loss rate history for a loan portfolio that has a four year term, with the shaded area representing future periods that must be forecasted. (In the chart, the current year is 2020. See that vintage year 2017 has one year remaining, vintage 2018 has two years remaining and so on.). In order to calculate the total LOL loss rates in the portfolio, four calculations are needed (one for each outstanding vintage).

However, since forecasts of the future will impact different vintages differently, ten different estimates (four for vintage year 2020, three for 2019, etc.), as shown in the red "Xs," would need to be performed. This process is much more complex than current processes for incurred losses.

Origination Year	**Loss Rates by Vintage**				
	Year 1	**Year 2**	**Year 3**	**Year 4**	**Total**
2015	0.20%	1.00%	1.40%	0.30%	2.90%
2016	0.25%	1.00%	1.50%	0.35%	3.10%
2017	0.30%	1.20%	1.30%	***XX%***	***XX%***
2018	0.25%	1.25%	***XX%***	***XX%***	***XX%***
2019	0.35%	***XX%***	***XX%***	***XX%***	***XX%***
2020	***XX%***	***XX%***	***XX%***	***XX%***	***XX%***

Collateral-Dependent Financial Assets

The new accounting standard defines a collateral-dependent financial asset as "a financial asset for which the repayment is expected to be provided substantially through the operation or sale of the collateral when the borrower is experiencing financial difficulty based on the entity's assessment as of the reporting date." The standard allows institutions to use, as a practical expedient, the fair value of the collateral to measure expected credit losses on collateral-dependent financial assets.

Similar to existing U.S. GAAP, if an institution uses the practical expedient on a collateral-dependent financial asset and repayment or satisfaction of the asset depends on the sale of the collateral, the fair value of the collateral should be adjusted for estimated costs to sell (on a discounted basis). However, the institution would not need to incorporate in the net carrying amount of the financial asset the estimated costs to sell the collateral if repayment or satisfaction of the financial asset depends only on the operation, rather than on the sale, of the collateral.

<u>Segmentation of Loan Portfolios</u>

CECL requires institutions to measure expected credit losses on financial assets carried at amortized cost on a collective or pool basis when similar risk characteristics exist. If a

financial asset does not share risk characteristics with other financial assets, the standard requires the expected credit losses on that asset to be measured on an individual asset basis (keeping in mind that any expected loss should be driven by internal credit monitoring policy and not merely a calculation made to comply with U.S. GAAP).

***Practice Note**:* As under the current incurred loss methodology, financial assets on which expected credit losses are measured on an individual basis should not also be included in a collective assessment of expected credit losses.

Similar risk characteristics may include one or a combination of the following:

- Internal or external (third-party) credit scores or credit ratings
- Risk ratings or classifications
- Financial asset type
- Collateral type
- Asset size
- Effective interest rate
- Term
- Geographical location
- Industry of the borrower
- Vintage
- Historical or expected credit loss patterns
- Reasonable and supportable forecast periods

Institutions will need to remove a financial asset from a pool if its risk characteristics are no longer similar to the other financial assets in the pool. For example, there may be changes in credit risk, borrower circumstances, recognition of write-offs or cash collections that have been fully applied to principal on the basis of nonaccrual practices that may require a reevaluation to determine if the asset has migrated to have similar characteristics with assets in another pool, or if the credit loss measurement of the asset should be performed individually because the asset no longer has similar risk characteristics.

<u>Data Considerations</u>

CECL is forward-looking and broadens the range of data that must be considered in the estimation of credit losses. More specifically, CECL requires consideration of not only past events and current conditions, but also reasonable and supportable forecasts that affect expected collectability. To perform the CECL calculations an institution will need a tremendous amount of data, including data on their loans, data on their borrowers, and data on the performance of the regional and national economy.

Data underlying most current ALLL estimates are not based on a LOL loss concept. In other words, current charge-off ratios, probabilities of default, loss given default, and rates based on past due status are based on yearly charge-offs. These rates, based on activity during specific time periods (such as one year), do not satisfy the LOL loss expectation requirement. Therefore, systems will need to be reconfigured and static pools will need to be maintained to adequately provide appropriate LOL loss rates.

CPEA Observation: Depending on the individual portfolio and accompanying credit risk management systems, origination data—a key part of the LOL loss analysis—may not exist and will need to be retrieved from hard-copy documents for the initial years of implementation.

Underwriting, origination, modification, loan review, workout/recovery/other real estate owned (OREO) systems will likely need to be linked and "audit ready," meaning that the information should essentially be tied to each loan. While it is theoretically possible that an institution could limit the data points needed to perform a specific CECL calculation, other data will likely be needed for practical purposes in order to appropriately analyze the credit risk each quarter. This data can include:

- Origination dates
- Maturity, renewal, and TDR dates
- Fixed versus variable rate indicators
- Current collateral values
- Ongoing changes to credit risk status (including delinquency, credit ratings, nonaccrual status)
- Charge-off and recovery amounts by loan, loan type, etc.
- Data likely to be needed to provide quantitative support to forecasts of the future (local real estate price indices, unemployment rates, etc.)

Practice Note*:* Institutions also may want to consider tracking and maintaining individual cash flows for certain kinds of loans, such as corporate lines of credit, as future draws on many lines of credit will need to be forecast.

While small institutions are not expected to perform sophisticated analysis to forecast future economic conditions, the resulting forecast of economic conditions should be consistent with assumptions used in other aspects of the business (capital planning, asset/liability management, etc.). For example, if interest rate increases are used in the institution's pricing tables, those increases also should be considered within a CECL estimate. It would not be appropriate for an institution to use assumptions in one aspect of the business that are contradicted by assumptions used for CECL. For practical purposes, many institutions may start with forecasts published by the Federal Reserve or

by other economic forecasting organizations, adjusting those national or regional forecasts as needed to reflect observations in the local community.

***Practice Note**:* No matter the planned level of sophistication, institutions should begin gathering as many relevant data points as possible, with the expectation that practice will likely evolve over the several years after the CECL effective date. Institutions will not want to be constrained in implementing future solutions that may improve their processes.

CECL Implications for Other Financial Assets

PCD Assets

The standard defines purchased financial assets with credit deterioration (PCD assets) as acquired individual financial assets (or acquired groups of financial assets with similar risk characteristics) that, as of the date of acquisition, have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment. Under current U.S. GAAP, an acquired asset is considered credit-impaired when it is probable that the investor would be unable to collect all contractual cash flows as a result of deterioration in the asset's credit quality since origination. Under the current accounting for purchased credit-impaired assets, an institution recognizes unfavorable changes in expected cash flows as an immediate credit impairment but treats favorable changes in expected cash flows that are in excess of the allowance as prospective yield adjustments (assuming no post acquisition credit impairment). However, the new standard requires an institution's method for measuring expected credit losses to be consistent with its method for measuring expected credit losses for originated and purchased non-credit-deteriorated assets. As a result, upon acquiring a PCD asset, an institution would recognize its allowance for expected credit losses as an adjustment that increases the cost basis of the asset (the "gross-up" approach). After initial recognition of the PCD asset and its related allowance, the institution would continue to apply the CECL model to the asset—that is, any changes in the institution's estimate of cash flows that it expects to collect (favorable or unfavorable) would be recognized immediately in the income statement.

Certain Beneficial Interests

For beneficial interest within the scope of ASC 325-40, *Investments—Other; Beneficial Interests in Securitized Financial Assets*, institutions will measure an impairment allowance for purchased or retained beneficial interests in the same manner as PCD assets if the beneficial interest meets the definition of a PCD asset or there is a significant difference between the contractual cash flows and expected cash flows of the beneficial interest. At initial recognition, a beneficial interest holder would therefore present an impairment allowance equal to the estimate of expected credit losses. In addition, the

standard requires institutions to accrete changes in expected cash flows attributable to factors other than credit into interest income over the life of the asset.

Other Considerations

Internal Control Requirements

Because loan originations will create immediate accounting events—loss expectations—under CECL, it is expected that additional detailed processes will be required to ensure that factors underlying loss expectations are appropriately identified and tracked. Such factors may include appraisals underlying loan-to-value ratios on collateral and analyses performed during underwriting. While this work currently may be performed operationally at many institutions, this is expected to be a new process within both a financial statement audit and an audit of internal controls over financial reporting (ICFR), since it is not currently assumed that the loan origination transaction creates a loss expectation.

Capital Planning

The earlier recognition of credit losses under CECL will likely increase allowance levels and lower the retained earnings component of equity, thereby lowering common equity tier 1 capital for regulatory capital purposes, although the actual impact to individual institutions is dependent on the point in the credit cycle, future expected conditions, and portfolio credit risk attributes.

***Practice Note**:* For credit unions, implementation of CECL will impact retained earnings and will likely lower regulatory net worth. However, it will not impact the measurement under the National Credit Union Association's risk-based capital rule that becomes effective in 2019. Under this new rule, the entire allowance balance will be reflected in capital for purposes of the new risk-based capital calculation.

In general, because a longer time horizon for measuring losses will be instituted, some increase in the ALLL is expected for all institutions which will result in a decrease in capital. Institutions will need to be proactive in estimating the potential impact to their regulatory capital ratios to assess whether they will have sufficient capital at the time that CECL goes into effect. As a result, institutions will need to be using CECL calculations in 2017 and 2018 to create simulations of the impact of the new models on the reserve to see the potential impact on their capital levels. Importantly, institutions with estimated capital ratios close to prompt correction action (PCA) minimums will need to develop a plan for the implementation of CECL to avoid unintentionally migrating to a lower PCA category.

Implementation

To plan and prepare for the transition to and implementation of the new accounting standard, members should encourage their financial institution clients to:

- Become familiar with the new accounting standard and educate the board of directors and appropriate institution staff about CECL and how it differs from the incurred loss methodology
- Determine the applicable effective date of the standard based on the PBE criteria in U.S. GAAP
- Determine the steps and timing needed to implement the new accounting standard
- Identify the functional areas within the institution that should participate in the implementation of the new standard
- Discuss the new accounting standard with the board of directors, audit committee, industry peers, external auditors, and supervisory agencies to determine how to best implement the new standard in a manner appropriate for the institution's size and the nature, scope, and risk of its lending and debt securities investment activities
- Review existing allowance and credit risk management practices to identify processes that can be leveraged when applying the new standard
- Determine the allowance estimation method or methods to be used
- Identify currently available data that should be maintained and consider whether any additional data may need to be collected or maintained to implement CECL
- Identify necessary system changes to implement the new accounting standard consistent with the new standard's requirements and the allowance estimation method or methods to be used
- Evaluate and plan for the potential impact of the new accounting standard on regulatory capital

Transition

For most debt instruments, institutions will record a cumulative-effect adjustment to the statement of financial position as of the beginning of the first reporting period in which the guidance is effective (modified retrospective approach). However, the standard provides the following instrument-specific transition guidance:

- Other-than-temporarily impaired debt securities—an institution is required to apply (1) the CECL model prospectively to HTM debt securities and (2) the changes to the impairment model for AFS debt securities prospectively. As a result, previous write-downs of a debt security's amortized cost basis would not be reversed; rather, only changes in the estimate of expected cash flows of the debt security occurring on or after the standard's effective date would be reflected as an allowance for credit losses. Upon adoption of the new guidance, any impairment

previously recognized in other comprehensive income would be accounted for as a prospective adjustment to the accretable yield of the debt instrument.

- PCD assets—an institution is required to apply the changes to PCD assets prospectively. That is, the change in the definition of a PCD asset applies only to assets acquired on or after the standard's effective date. For debt instruments accounted for under ASC 310-30, *Receivables; Loans and Debt Securities Acquired with Deteriorated Credit Quality*, an institution would apply the gross-up approach as of the transition date (i.e., establish an allowance for expected credit losses with a corresponding adjustment to the debt instrument's cost basis). In addition, an institution would immediately recognize any postadoption changes to its estimate of cash flows that it expects to collect (favorable or unfavorable) in the income statement as impairment expense (or reduction of expense). Accordingly, the yield on a PCD asset as of the date of adoption would be "locked" and would not be affected by subsequent changes in the institution's estimate of expected credit losses.
- Certain beneficial interests—institutions holding such interests need to comply with the same transition requirements as those that apply to PCD assets.

Audit Implications

In the past several years, bank auditors and examiners have increased their demands for banks to provide documentation that quantifies how specific drivers of credit risk (macroeconomic factors, underwriting standards, etc.) have affected their incurred loss expectations, significantly increasing the complexity of ALLL estimates made today under the incurred loss model. Under CECL, the complexity escalates, as forecasts of the impact of future levels of an economic driver (e.g., a forecast of unemployment or of interest rates) on a loan portfolio will affect different loans differently, based on their loan terms and age. For example:

- Future interest rate increases will affect variable-rate loans differently from fixed-rate loans
- Forecasts of losses on those variable-rate loans will differ for those that mature within the next year compared to those that will be outstanding for the next two to three years
- Borrowers with lower credit ratings will perform, over time, to such interest rate changes differently than those with higher credit ratings

Forecasting future levels of economic drivers and their impact on credit losses is difficult. However, the potentially much larger and more volatile CECL balances and credit loss provisions present an additional challenge to institutions in supporting their estimates. The International Auditing and Assurance Board, in providing their initial views of

expected credit loss models in light of their project to amend auditing standards related to estimates, observes this:

> "Given the complexity and uncertainty implicit in an ECL (expected credit loss) model, and the significant level of judgment that is involved in measuring the ECL, it is possible that the auditor's range, or difference between management's estimate and the auditor's point estimate, may be multiples of performance materiality."

> "Large ranges can result from only minor differences in assumptions due to…sensitivity of the output to changes in the assumptions. It is possible that well-credentialed and experienced experts may disagree with respect to the appropriate assumptions for a given circumstance."

Auditors likely will need greater quantitative support for the qualitative factor adjustments. While the complexity and sophistication of the CECL analysis will be consistent with the complexity and sophistication of the institution itself, the practical requirement of additional data and analysis will still need to be addressed, and the level of detail can be expected to be greater than under current accounting.

***Practice Note**:* A significant portion of audit deficiencies noted by the Public Company Accounting Oversight Board (PCAOB) relate to accounting estimates (of which the ALLL is one). The greater judgment required under CECL (as compared to the current ALLL process) is expected to put more pressure on auditors in complying with PCAOB standards.