ACCOUNTING UPDATE

11/6/2023

New Current Expected Credit Loss (CECL) Standard in Effect for Both Bank and Nonbank Entities

Changes to the credit loss model have been updated effective January 1, 2023 via Accounting Standards Update No. 2016-13 (ASU No. 2016-13). The goal of ASU No. 2016-13 is to update a perceived weakness in US GAAP by updating impairment accounting for financial instruments to add an impairment model known as current expected credit losses (CECL). Many entities are under the false pretense this new standard only applies to financial institutions; however, it actually applies to any nonbank entity with common financial instruments, such as trade receivables and credit card receivables.

CECL Explained

Certain financial instruments, such as accounts receivables and credit card receivables (i.e., receivables subject to ASC 606), are generally subject to the new credit loss calculations. Prior to ASU No. 2016-13, credit losses were calculated and recognized using an "incurred loss" methodology. The new model is based on expected losses at the end of the reporting period. Instead of being labeled as a direct write-down of the amortization cost-basis, credit impairment is instead noted as an allowance (a contra-asset).

Nonbank entities should note that there are a few exceptions that do not apply to the CECL model, including:

- For not-for-profit entities: pledge receivables
- Any loans or receivables made between entities that are under common control participant loans from defined contribution employee benefit plans
- For insurance entities: policy loan receivables

How to Achieve Compliance

There are two tasks nonbank entities should focus on in order to gauge eligibility and maintain compliance with the new CECL rules:

- Identify financial assets that are applicable to the new methodology
- Evaluate the need to update current credit impairment models
    - Select from a number of measurement approaches to be consistently applied to particular asset pools, such as: aging schedule, loss-rate, roll-rate, probability-of-default, and discounted cash flow

All entities with any qualifying assets must adopt CECL as part of their accounting processes. These new methodologies went into effect on January 1, 2023 and apply to reporting periods after December 15, 2022 (i.e. December 31, 2023 yearends and after).

Impact of Non-Compliance

It's important to implement the new CECL standards immediately. Otherwise, your entity faces the risk of:

- Financial misstatements, including inadequate disclosures
- The potential for restatements
- Regulatory inquiries

The new CECL guidelines are complex, so it's important to work with your Seiler advisor to ensure compliance is met within the appropriate timelines.