Heads Up | Volume 27, Issue 15
July 22, 2020

In This Issue

- Introduction
- Population Demographics
- General Observations Related to Nonbanks
- Reasonable and Supportable Forecasts
- Reasonable and Supportable Forecast Period
- Off-Balance-Sheet Credit Exposures
- COVID-19 Considerations
- Thinking Ahead

Are Your CECL Disclosures in Good Standing? Observations on First-Quarter Filings

by Ryan Pringle and Stephen McKinney, Deloitte & Touche LLP

Introduction

The FASB's new current expected credit loss (CECL) standard (i.e., the guidance in ASU 2016-13,[1] as amended,[2] which is codified in ASC 326[3]) adds to U.S. GAAP an impairment model (the "new CECL model") that is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes its estimate of expected credit losses as an allowance, which incorporates forward-looking information and eliminates barriers to the timely recognition of losses under legacy incurred loss models.

[1] FASB Accounting Standards Update (ASU) No. 2016-13, *Measurement of Credit Losses on Financial Instruments*.

[2] To amend and clarify the guidance in ASU 2016-13, including the effective date and transition provisions, the FASB subsequently issued the following ASUs:
- ASU 2018-19, *Codification Improvements to Topic 326,* Financial Instruments — Credit Losses.
- ASU 2019-04, *Codification Improvements to Topic 326,* Financial Instruments — Credit Losses, *Topic 815,* Derivatives and Hedging, *and Topic 825,* Financial Instruments.
- ASU 2019-05, *Financial Instruments — Credit Losses (Topic 326): Targeted Transition Relief*.
- ASU 2019-10, *Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*.
- ASU 2019-11, *Codification Improvements to Topic 326,* Financial Instruments — Credit Losses.
- ASU 2020-02, *Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02,* Leases (Topic 842).
- ASU 2020-03, *Codification Improvements to Financial Instruments*.

For entities that have not yet adopted the guidance in ASU 2016-13, the effective date of the subsequently issued ASUs is the same as that of ASU 2016-13. However, for entities that have already adopted the guidance in ASU 2016-13, the subsequently issued ASUs are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years.

[3] FASB Accounting Standards Codification Topic 326, *Financial Instruments — Credit Losses*.

The guidance in ASC 326 was effective in the first quarter of 2020 for most calendar-year-end public business entities that are SEC filers (as defined in U.S. GAAP), excluding smaller reporting companies (as defined by the SEC). The new CECL standard does not prescribe any single method for determining expected credit losses. Consequently, entities have latitude to develop processes that are appropriate for the credit risk (and financial statement misstatement risk) associated with assets within the scope of the new CECL model. Similarly, the disclosure requirements under the new CECL standard are principles-based and give entities flexibility to determine the nature and extent of the information to be disclosed while ensuring that the entities provide sufficient information to enable users of their financial statements to understand the following (to the extent that the estimate of expected credit losses is material):

- "The credit risk inherent in a portfolio and how management monitors the credit quality of the portfolio" (ASC 326-20-50-2(a)).[4]
- "Management's estimate of expected credit losses" (ASC 326-20-50-2(b)).
- "Changes in the estimate of expected credit losses that have taken place during the period" (ASC 326-20-50-2(c)).

This *Heads Up* summarizes the disclosure trends we observed in our review of public filings of a sample of companies that adopted the new CECL standard as of the first quarter of 2020, including disclosure trends related to the coronavirus disease 2019 ("COVID-19") pandemic. Although we identified certain disclosure trends, the principles-based nature of the new CECL standard resulted in diversity in the information disclosed among the companies in our sample. For a comprehensive discussion of the new CECL standard, including all presentation and disclosure requirements, see Deloitte's ***A Roadmap to Accounting for Current Expected Credit Losses***.

Population Demographics

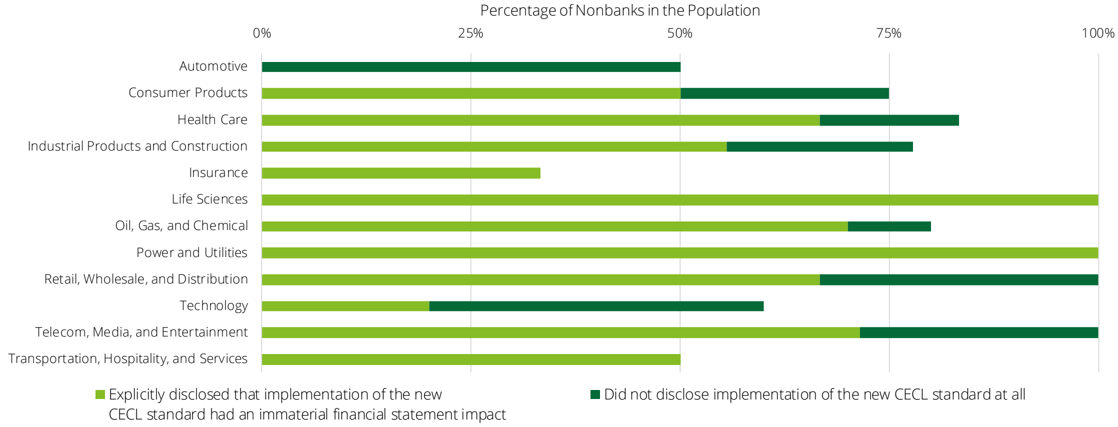
The discussion in this *Heads Up* is based on the disclosures provided in the first-quarter Form 10-Q filings of over 90 companies that adopted the new CECL standard as of January 1, 2020 (collectively referred to hereafter as the "entities" or the "Population"), which comprise (1) the top 25 banking and capital markets companies and (2) certain Fortune 100 nonbank entities. The entities are from various industries, including automotive, consumer products, financial services, industrial products and construction, insurance, health care, life sciences, oil and gas, power and utilities, retail and distribution, and technology. The discussion below summarizes several key categories of disclosures required under the new CECL standard and highlights trends identified in the sample of filings.

General Observations Related to Nonbanks

The financial reporting impact of the new CECL standard varies depending on the industry. While banks and other financial institutions (e.g., credit unions and certain asset portfolio companies) are often viewed as being the most significantly affected by the new CECL standard from a financial reporting and regulatory perspective, ASC 326 applies to all entities. However, because financial assets of nonbanks tend to be held for a shorter duration than those of banks, nonbanks will generally be less affected by the new CECL standard. We observed that many nonbank entities either (1) disclosed that the impact of the new CECL standard is immaterial to their financial statements or (2) did not disclose the adoption of the new CECL standard at all. The chart below summarizes our observations on the new CECL standard's impact on the financial statements of nonbanks in the Population.

[4] FASB Accounting Standards Codification Subtopic 326-20, *Financial Instruments — Credit Losses: Measured at Amortized Cost*.

Observations on the New CECL Standard's Impact on the Financial Statements of Nonbanks in the Population



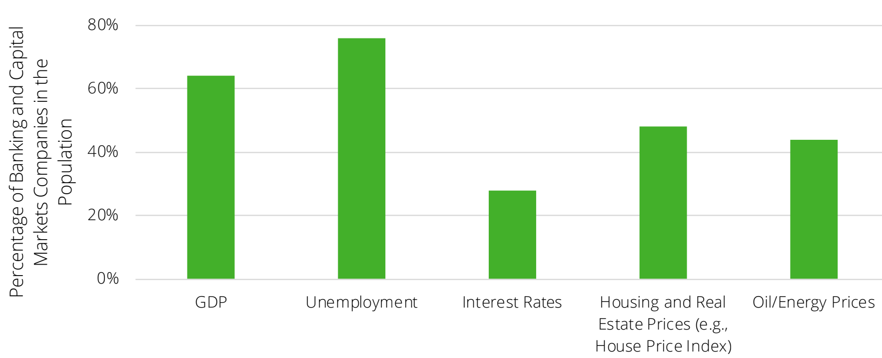
Connecting the Dots — Impact of the New CECL Standard on Nonbanks' Financial Statements

Various nonbank entities did not explicitly state that the financial statement impact of implementing the new CECL standard was immaterial. However, we generally do not believe that this fact should be interpreted to mean that the new CECL standard materially affected those entities. For example, a nonbank entity that did not disclose that its implementation of the new CECL standard was immaterial to its financial statements may opt to disclose the quantitative impact without disclosing the materiality or significance of the impact to the entity.

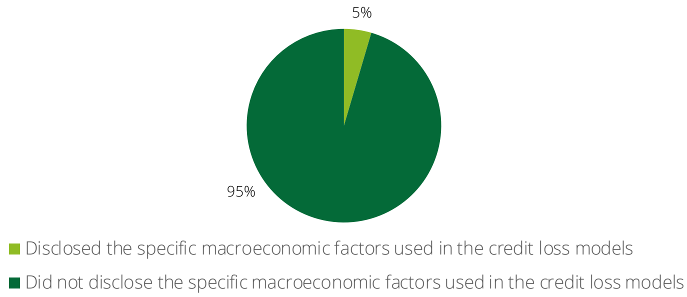
Reasonable and Supportable Forecasts

The guidance in ASC 326 requires entities to consider available information relevant to assessing the collectibility of cash flows under the new CECL model. This information may include internal information, external information, or a combination of both related to past events, current conditions, and reasonable and supportable forecasts. In accordance with the principles-based nature of the new CECL standard, the guidance in ASC 326 does not prescribe any specific information that entities must use when calculating the expected credit loss estimate. We observed that banking and capital markets companies in the Population disclosed various macroeconomic factors used in their credit loss models. We also observed that many nonbank entities did not disclose the specific forward-looking information incorporated into their credit loss models but opted to disclose their consideration of general macroeconomic information. Of the nonbank entities in the Population, 95 percent did not disclose the specific macroeconomic information that was used in the new CECL model. The charts below summarize the most prevalent forward-looking information disclosed by the entities in the Population and present the percentage of entities that disclosed each factor, segregated by (1) banking and capital markets companies and (2) all other entities.

Observations on the Macroeconomic Factors Used in the Credit Loss Models — Banking and Capital Markets Companies in the Population



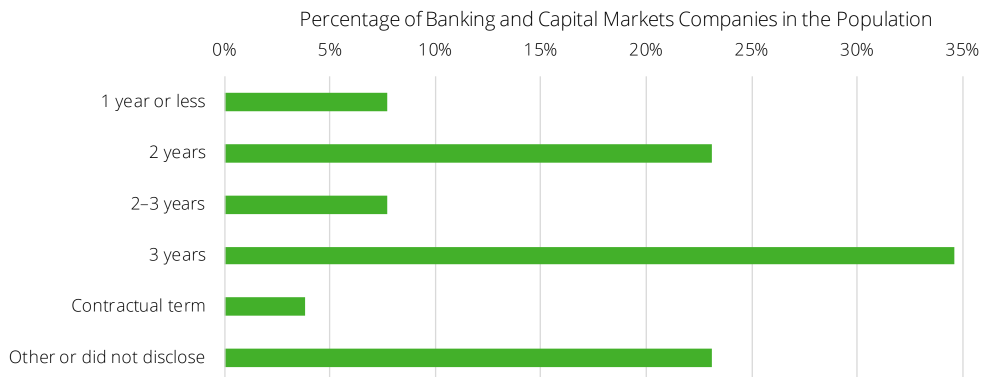
Observations on the Macroeconomic Factors Used in the Credit Loss Models — All Other Entities in the Population



Reasonable and Supportable Forecast Period

ASC 326-20-30-9 states that an entity "shall consider the need to adjust historical information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated." However, ASC 326-20-30-9 also states that an "entity shall not adjust historical loss information for existing economic conditions or expectations of future economic conditions for periods that are beyond the reasonable and supportable period." The chart below summarizes the trends we identified with respect to the length of the forecast period used in the credit loss models for banking and capital markets companies.

Observations on the Length of the Reasonable and Supportable Forecast Period — Banking and Capital Markets Companies in the Population



Connecting the Dots

We expect the COVID-19 pandemic to affect the forward-looking information used in the new CECL model. For example, entities that have adopted ASC 326 may decide to shorten the reasonable and supportable forecast period for certain portfolios because of the forecast uncertainty that results from the pandemic. In these situations, entities should also reevaluate both the reversion period and the historical loss data used for reversion purposes. For example, when an entity shortens the reasonable and supportable forecast period, it would most likely also increase the reversion period. In addition, depending on the remaining contractual maturity of the portfolio, the entity may further determine that the historical loss information used in the postreversion period should reflect losses incurred during a volatile economic environment (as opposed to long-term loss data over an entire economic cycle). See the COVID-19 Considerations section for more insights.

We observed that many nonbank entities did not disclose the length of the reasonable and supportable forecast period used in their credit loss models. Of the nonbank entities in the Population, over 90 percent did not disclose the length of the forecast period used in their credit loss models. This trend is consistent with the general assumption that many nonbank entities have financial assets that have short contractual lives (e.g., one year or less).

Off-Balance-Sheet Credit Exposures

The guidance in ASC 326 applies to off-balance-sheet credit exposures such as unfunded loan commitments and standby letters of credit. A liability for expected credit losses for off-balance-sheet credit exposures is recognized if (1) the entity has a present contractual obligation to extend the credit and (2) the obligation is not unconditionally cancelable by the entity. The disclosure guidance under the new CECL standard requires an entity to disclose the accounting policies and method it used to estimate its liability for off-balance-sheet credit exposures. Because of the principles-based nature of the new CECL standard, we observed diversity in both the nature and the extent of disclosures related to off-balance-sheet credit exposures in the Population. However, we also observed that banking and capital markets companies generally disclosed that the method used to calculate the credit loss estimate for off-balance-sheet credit arrangements is consistent with the method used to estimate the allowance for credit losses on financial assets held at amortized cost. The primary difference between the two estimates is that the credit loss estimate for off-balance-sheet credit arrangements also includes an estimate of the likelihood that the funding will occur.

COVID-19 Considerations

The COVID-19 pandemic is affecting major economic and financial markets, and virtually all industries are facing challenges associated with the economic conditions resulting from efforts to address it. In response to the pandemic, governments and other regulatory bodies have taken certain actions to help alleviate the financial burden caused by COVID-19. The sections below summarize observations identified in the Population with respect to certain governmental and regulatory initiatives.

The CARES Act and Interim Final Rule

On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security Act (the "CARES Act"), which provides relief from certain accounting and financial reporting requirements under U.S. GAAP. The CARES Act, in part, provides certain qualifying entities with optional temporary relief from applying the new CECL standard. In addition, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency (the "Agencies") issued an interim final rule (IFR) that, as of its effective date of March 31, 2020, gives certain qualifying entities the option to delay the estimated impact on regulatory capital stemming from the implementation of the new CECL standard for two years, followed by a three-year transition period. The IFR applies to banking organizations that implement CECL before the end of 2020. See Deloitte's *Heads Up*, "Highlights of the CARES Act," for a comprehensive summary of the CARES Act.

Deferral of the New CECL Standard

Section 4014 of the CARES Act offers optional temporary relief from applying the new CECL standard for the following qualifying entities:

- Insured depository institutions,[5] as defined in Section 3 of the Federal Deposit Insurance Act.
- Credit unions regulated by the National Credit Union Administration.

[5] The CARES Act states that the relief applies to an insured depository institution, bank holding company, or any affiliate thereof.

Qualifying entities are not required to comply with the new CECL standard during the period beginning on the date of enactment and ending on the earlier of the following:

- The termination date of the national emergency declared by President Trump under the National Emergencies Act on March 13, 2020, related to the outbreak of COVID-19.
- December 31, 2020.

The table below summarizes our observations based on our review of the filings of qualifying entities in the Population.

Description	Guidance	Observations
Deferral of the new CECL standard	Section 4014 of the CARES Act	All qualifying entities in the Population chose not to elect the optional temporary relief from applying the new CECL standard.

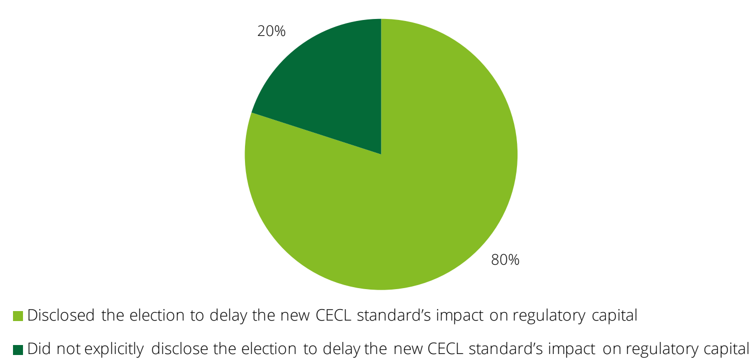
For more information about qualifying entities, see Deloitte's *Heads Up*, "Congress Shows That It CARES About Accounting Rules for Banks and Credit Unions."

Delay of the Impact of the New CECL Standard on Regulatory Capital

As noted above, the IFR issued by the Agencies gives banking organizations that implement the new CECL standard before the end of 2020 the option to delay the estimated impact on regulatory capital stemming from the implementation of the new CECL standard for two years, followed by a three-year transition period. The table and chart below summarize our observations based on the filings of qualifying entities in the Population.

Description	Guidance	Observations
Delay of the new CECL standard's impact on regulatory capital	IFR	Of the 25 banking and capital markets companies in the Population, 80 percent disclosed that they elected the option to temporarily delay the effects of the new CECL standard on regulatory capital for two years, followed by a three-year transition period.

Observations on the Delay of the New CECL Standard's Impact on Regulatory Capital — Banking and Capital Markets Companies in the Population

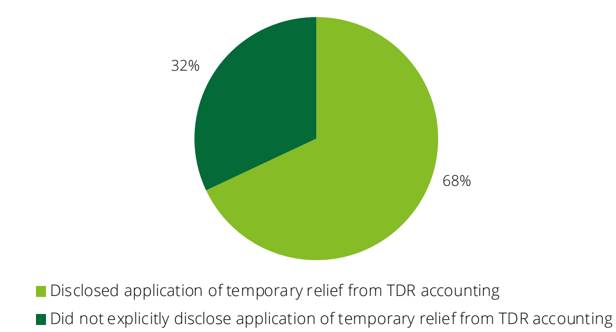


Relief From Troubled Debt Restructurings

Section 4013 of the CARES Act provides temporary relief from the accounting and reporting requirements for troubled debt restructurings (TDRs) regarding certain loan modifications related to COVID-19 that are offered by insured depository institutions and credit unions (i.e., the same entities that qualify for the optional deferral of the new CECL standard described above). Specifically, the CARES Act provides that a qualifying financial institution may elect to suspend (1) the requirements under U.S. GAAP for certain loan modifications that would otherwise be categorized as a TDR and (2) any determination that such loan modifications would be considered a TDR, including the related impairment for accounting purposes. See Deloitte's *Heads Up*, "Frequently Asked Questions About Troubled Debt Restructurings Under the CARES Act and Interagency Statement," for more information about the temporary relief from the accounting and reporting requirements for TDRs.

We observed that approximately 70 percent of the 25 banking and capital markets companies in the Population disclosed that they elected to apply the temporary relief from the accounting and reporting requirements for TDRs. Although the other banking and capital markets companies in the Population did not explicitly state that they applied the relief, most of these remaining companies either (1) disclosed that they were still evaluating how the relief would affect them if they elected to apply it or (2) disclosed that they did not have any loan modifications that would qualify as a TDR under U.S. GAAP in the quarter. The chart below summarizes our observations based on the filings of qualifying entities in the Population.

Observations on the Election of Temporary Relief From TDR Accounting Under the CARES Act

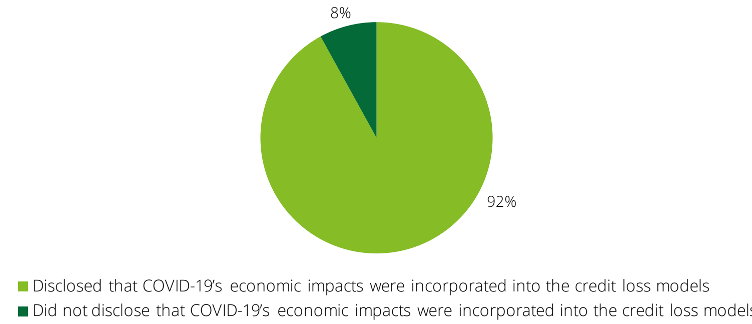


Other COVID-19 Observations

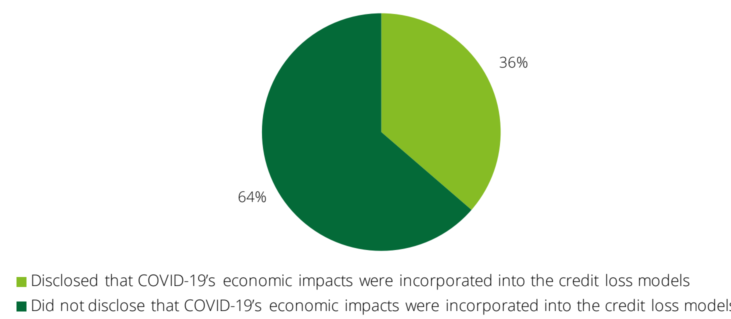
As a result of the COVID-19 pandemic, most entities are experiencing conditions that are often associated with a general economic downturn, including, but not limited to, financial market volatility and erosion of market value, deteriorating credit, liquidity concerns, further increases in government intervention, increasing unemployment, broad declines in consumer discretionary spending, increasing inventory levels, reductions in production because of decreased demand and supply constraints, layoffs and furloughs, and other restructuring activities. Since the continuation of these circumstances could have a prolonged negative impact on an entity's financial condition and results, we would generally expect the impact of the COVID-19 pandemic to be incorporated into the forward-looking information used in the new CECL model. The table and charts below summarize our observations identified in the Population.

Description	Guidance	Observations
Disclosure that information about current conditions and reasonable and supportable forecasts includes macroeconomic conditions caused by the COVID-19 pandemic	ASC 326-20-50-11	Of the 25 banking and capital markets companies in the Population, over 90 percent disclosed that the economic conditions caused by COVID-19 were considered in their credit loss models. Of the nonbank entities in the Population, approximately 40 percent disclosed that the conditions caused by COVID-19 were considered in their credit loss models, whereas the roughly 60 percent remaining did not mention factoring COVID-19 into their credit loss models.

Observations on the Incorporation of COVID-19's Economic Impacts Into Credit Loss Models — Banking and Capital Markets Companies in the Population



Observations on the Incorporation of COVID-19's Economic Impacts Into Credit Loss Models — All Other Entities in the Population



Connecting the Dots — Impact of COVID-19 on Estimates of Expected Credit Losses

In accordance with ASC 326-20-30-9, an "entity shall not rely solely on past events to estimate expected credit losses." Rather, as noted above, an entity "shall consider the need to adjust historical information to reflect the extent to which management expects current conditions and reasonable and supportable forecasts to differ from the conditions that existed for the period over which historical information was evaluated." Although we observed that some companies, particularly in the nonbanking industries, did not explicitly disclose that the general economic conditions caused by COVID-19 were factored into their credit loss models, we would generally expect that historical information used in credit loss models would need to be adjusted accordingly given the rapid onset of the COVID-19 pandemic and the resulting general economic downturn.

Thinking Ahead

Although the adoption of the new CECL standard had varying levels of impact on entities' financial statements, processes, and controls depending on the industry, the rapid onset of the COVID-19 pandemic in the first quarter of 2020 introduced economic uncertainty that affected all entities to some extent. We expect CECL disclosures to continue evolving as accounting standard setters clarify guidance, regulators review disclosures and issue comments, and entities evaluate their peers' filings.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Business strategy and tax.
- Controllership perspectives.
- Driving enterprise value.
- Financial reporting.
- Governance, risk, and compliance.
- Innovation in risk and controls.
- Tax accounting and provisions.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk.

Subscriptions

To subscribe to *Dbriefs*, or to receive accounting publications issued by Deloitte's Accounting Services Department, please register at My.Deloitte.com.

The Deloitte Accounting Research Tool

Put a wealth of information at your fingertips. The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosure literature. It contains material from the FASB, EITF, AICPA, PCAOB, and SEC, in addition to Deloitte's own accounting manuals and other interpretive guidance and publications.

Updated every business day, DART has an intuitive design and navigation system that, together with its powerful search and personalization features, enable users to quickly locate information anytime, from any device and any browser. While much of the content on DART is available at no cost, subscribers have access to premium content, such as Deloitte's *FASB Accounting Standards Codification Manual*. DART subscribers and others can also subscribe to *Weekly Accounting Roundup*, which provides links to recent news articles, publications, and other additions to DART. For more information, or to sign up for a free 30-day trial of premium DART content, visit dart.deloitte.com.