CECL Topics Added to the FASB Agenda

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On July 14th, the Financial Accounting Standards Board (FASB) conducted a decision-making meeting on several topics related to CECL that could impact CECL adopters or those thinking about early adopting CECL.

"There is an awkwardness to saying, 'I bought a financial institution where 50% of its loans are credit deteriorated'" [in order to get the benefit of PCD accounting].
James Kroeker, FASB Board Member

"I haven't heard any analysts tell me that the information is decision-useful. The comments we generally hear are that the accounting is complex and confusing... in terms of the PCD versus Non-PCD, I gross up PCD and I write down Non-PCD? From an analyst perspective, that's counterintuitive."
Gary Buesser, FASB Board Member

Board members offered their comments and votes on three primary topics including eliminating TDR accounting for CECL adopters, expansion of the PCD treatment to Non-PCD assets as a part of a business combination, and requiring additional details on gross charge-offs and gross recoveries in a vintage disclosure. All topics were voted to remain on or be added to the technical agenda, which could lead to future Accounting Standard Updates (ASUs) that will supersede the current guidance.

When reading through the meeting handout prepared by the FASB staff as well as listening to the discussion from the board members, it was quite apparent that the Non-PCD accounting model has many flaws. After all, in the context of acquired loans in a business combination, the assets are marked to fair value as a part of the business combination, which includes a reduction in fair value for expected losses. However, the current CECL guidance requires an additional Allowance for Credit Losses (ACL) to be booked as well which creates the infamous double count. Furthermore, feedback from researchers indicated that although the definition of PCD has a lot of room for interpretation, entities were hesitant to put too much into PCD as it has a negative connotation to it. Although the double count does result in immediate provision expense, there is a benefit to interest income as the expected losses as a part of the fair value mark are accreted under ASC 310-20 into interest income. Although positive, this has timing implications and analysts are not able to easily peel out accounting yield from fundamental interest income yield.

As such, it is safe to assume that the FASB will issue updated guidance in the near future to address such shortfall.

On The Other Hand...

As FASB Board member Christine Botosan eloquently pointed out, this is a new standard and there is still a lot of confusion surrounding the guidance. For example, stakeholders want to avoid the double count, which leads to an expanded PCD framework. However, there is also reluctance against yield distortion. This can occur with acquired assets for both PCD and Non-PCD, but under PCD, the yield is generally deflated and can be further distorted due to the asset being grossed up by the ACL. Furthermore, many board members mentioned complexities or carry-on issues related to several topics including AFS/HTM securities, credit cards, and other revolvers, asset purchases, and potential ACL avoidance strategies, such as being able to purchase portfolios immediately after origination by a broker and not having to record a provision expense at the expense of a compressed yield.

Also, beyond adding PCD expansion to the FASB agenda, there were also two other projects added that will likely be addressed sooner by the FASB due to resource constraints, usefulness to stakeholders, and a clearer objective of the changes. These changes include eliminating TDR accounting for CECL adopters in lieu of more disclosures related to modifications, forbearance agreements, duration of modification, and success of modification. Although the CARES act and other regulatory guidance have limited the volume of TDRs during the pandemic, the CARES act is set to expire by January 1, 2022, or earlier if the national emergency is lifted. It appears that FASB is looking to expedite new guidance ahead of the CARES act expiration.

There was also a discussion on aligning the guidance with its original intent on vintage disclosures, which would include gross write-offs and gross recoveries by vintage year in the vintage disclosure. Stakeholders communicated that they were expecting more information and that this is limited by the quality of the current disclosures. By keeping this project on the technical agenda, it is essentially a decision to expedite a decision, as the alternative would be to let the Post Implementation Review (PIR) process capture any incremental improvements which is generally a longer-term process.

It is evident that there is a need for additional education on the subjects, and certain subjects will require some time for FASB to examine further. Nevertheless, Valuant is committed to partnering with entities to ensure continuous education and the compliance of ValuCast with the latest guidelines as an end-to-end solution. Be sure to keep an eye out as new developments become available through FASB on these topics.

About the Author

Craig is a co-founder of Valuant and has more than twelve years of public accounting, consulting, and software development experience. He serves as the CFO and Director of Product Management working with both the Product Team and Client Service Team. He plays a key role in ValuCast™, a proprietary suite of software tools. When Craig is not working at Valuant, you can find him mountain biking or enjoying time with his wife and two daughters.