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After numerous delays and extensions, the Financial Accounting Standards Board (FASB) issued its long-awaited final standard on accounting for credit losses on Thursday. After meeting with concerned community bankers, auditors and regulators, the board has adopted the final standard, commonly referred to as the current expected credit loss model.

"The CECL model will be the new GAAP-supported standard for U.S. banks, credit unions and lenders to account and plan for credit losses," said Brian Hamilton, Sageworks Chairman. The proposal is "non-prescriptive," meaning that no specific methodologies will be required by the standard. "It includes several changes, including forward-looking requirements, which will involve considering all expected, future credit losses," Hamilton added. Many industry experts agree that institutions will need to alter their methodology or adopt one that is more robust. "It will play a central role in determining the allowance for credit losses, which is one of the most significant estimates in an institution's financial statements and regulatory reports," Hamilton continued.

"Every bank and credit union is going to have a certain number of loans that default each year," explains Tim McPeak, an executive risk management consultant for Sageworks. "These 'bad' loans are recognized as losses for the institution, and it's up to each financial institution to determine an appropriate amount of money to set aside as a reserve, or safety net, to cover these losses."

With the CECL model, the FASB has shifted financial institutions' focus to a more

historical and current information, institutions have been recognizing and accounting for a loss when it is "probable and estimable."

How Will This Impact Banks

Under the new GAAP-supported CECL model:

1. Institutions will have to incorporate forward-looking information into their loan loss estimate. Under the previous incurred loss model, institutions only have to look at past and present information. The "historic or incurred losses" threshold has been eliminated under the CECL model.
2. Institutions will be required to incorporate economic forecasts and other assessments of the lending and business environments as part of the qualitative adjustments they use in their reserve calculations.
3. Institutions must estimate and recognize losses anticipated over the entire contractual term of the financial assets at the time of origination.

What Is The Timeline For Implementation?

For public business entities that meet the definition of an SEC filer, the standard will be effective for fiscal years (and interim periods within those fiscal years) beginning after December 15, 2019. For non-SEC filing public business entities, the forthcoming standard will be effective for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.

For all other entities, including not-for-profit organizations and employee benefit plans, the standard will be effective for fiscal years beginning after December 15, 2020, and interim periods within fiscal years beginning after December 15, 2021.

All institutions will have the option to adopt the new accounting standard early, for fiscal years beginning after December 15, 2018.

“Community banks need to plan accordingly now, as it will grow in importance,”

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