losses; rather, they are recognized on day one. This day-one recognition of expected credit losses is likely the most controversial provision of the new guidance.

Jul. 31, 2016

In June, the FASB issued its long-awaited financial instruments impairment standard. The scope of the standard is broad, so while financial services companies will experience the biggest impact, all companies, in all sectors, will need to apply aspects of the new standard. For example, industrial companies will need to apply the new model to their trade receivables.

The impairment guidance will apply to:

2008-2009 financial crisis regarding the delayed recognition of credit losses. The new model removes the current GAAP threshold that delays the recognition of a credit loss until it is "probable" a loss event has been "incurred," (i.e., the "incurred loss" model), and replaces it with a forward-looking "expected" loss model. This new model is referred to as the current expected credit loss or "CECL" model.

Under the new model, there is no trigger event before booking expected credit losses; rather, they are recognized on day one. This day-one recognition of expected credit losses is likely the most controversial provision of the new guidance.

How it works

The estimate of expected credit losses will consider historical information, current information, and reasonable and supportable forecasts, including estimates of prepayments. By requiring the consideration of reasonable and supportable forecasts of future events, the CECL model will accelerates the recognition of credit losses as compared to current GAAP. Companies will need to record credit losses before they occur, for events they can foresee. For the most part, the initial estimate of credit losses and subsequent changes to the estimate will be recorded in the P&L.

The new guidance also modifies the impairment model for available-for-sale (AFS) debt securities. It requires an estimate of expected credit losses only when the fair value is below the amortized cost of the asset and credit losses will be limited to the difference between the security's amortized cost basis and its fair value. The length of time the fair value of an AFS debt security has been below the amortized cost will no longer impact the determination of whether a credit loss exists; it is no longer an other-than-temporary model. The AFS debt security model will also require the use of an allowance to record estimated credit losses (and subsequent recoveries). This is a significant change from the current model.

Need for new process and controls

standard will be effective for SEC filers in fiscal years beginning after December 15, 2019.

For more information on this standard, join PWC's upcoming webcast on 7/25 or refer to PwC's In depth: The FASB's new financial instruments impairment model.

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