Get Your DATA Together – Preparing for FASB's Proposed ASU, Financial Instruments: Credit Losses

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I attended the AICPA Conference on Credit Unions in Denver, Colorado in late October 2014. One of the few continuing professional education events for CPAs that is solely dedicated to the credit union industry, I look forward to the accounting updates at this event that are specifically geared to how the standards apply within this industry. I know what you are thinking, why would anyone look forward to an accounting update? Well, with the technical standards that the FASB has been bringing forth in recent years, if you aren't taking advantage of these educational opportunities, whether you are in a public or private accounting environment, you will find your head spinning when the implementation deadlines are upon you. For instance, the FASB has been working on its Proposed Auditing Standard Update, "Financial Instruments: Credit Losses" (Subtopic 825-15) since December 2012. The FASB has been deliberating and re-deliberating this monumental change from the existing incurred loss model to the proposed expected loss model, commonly known as the CECL (Current Expected Credit Loss) model (pronounced Cee-sill), for nearly two years. This updated standard will turn the calculation of an entity's allowance for credit losses (allowance for loan and lease losses (ALLL) for credit union's specifically) on its head when it becomes effective.

One of the featured sessions at this year's conference, ALLL New Methodology Nuts and Bolts, focused on this eagerly awaited standard update. Michael T. Umscheid, CPA, provided a deep dive into this topic that had been touched upon in an earlier session, Accounting and FASB Update. Mr. Umscheid's session focused on the theme of "DATA, DATA, DATA – the most important part of CECL". I concur with Mr. Umscheid's assessment of implementing the potential new standard.

Back to School

For those that have finally gotten their minds fully wrapped around the current methodologies for calculating the ALLL, the new guidance will have you back to the drawing board to figure out the new calculations, or like several of the attendees around me in this session – calculating your retirement date to see if it will be before implementation of this new standard! The proposed new standard seems daunting. If you have recently come to terms with what is affectionately known as "FAS 114" for handling your impaired loans, take a seat before reading further, "FAS 114" will be gone. Have you regained your composure yet? Brace yourself again because here it comes, you may need to utilize Regression Analysis for your new expected credit loss computations. We all remember how much we loved statistics class! This all leads back to why Mr. Umscheid and, after this session, I feel "DATA, DATA, DATA" is so important to the CECL model.

DATA – What Is It Good For?

As Mr. Umscheid clearly pointed out in his presentation, "Good data is better than bad data" and "More data is better than less data". Between now and the implementation date, you will need to get a handle on the quality and quantity of your data and assess areas such as the following: what data is most meaningful to your ALLL calculations; is that information currently available from your systems or will new reports or possibly a whole new system be necessary to provide adequate data; are your current

loan segments and classes adequate to compute a meaningful ALLL or will new pools need to be established; do you have adequate prepayment information available for your portfolio (yes, in addition to the contractual cash flows over the life of the loan, prepayment information will need to be included in your calculations, and it must be reasonable); do you have appropriate information for your loan commitments; what period will you be able to reasonably forecast and support; have you done any mergers that will impact your historical loss and recovery data; did you keep any historical data from the merged in institution; does your core system include recovery data; have you done a core system conversion during the period from which you will need historical data; have you written over data fields such as FICO scores or included multiple scores in one data field when obtaining updated scores or adding borrowers to a loan; have you ever obtained updated FICO scores. While this list seems voluminous, it is far from all-inclusive of the data you will need to consider in preparing for this new standard.

You will not only need to figure out what data you have, but whether and how that data may be relevant. For example, what if you merged in an institution that had very limited collection processes and procedures in operation prior to the merger? Would data available from the pre-merger timeframe be useful in your new calculations if you have subsequently put a robust collection program into effect for these loans and are recovering a significant portion of the balances? The data may be useful, but maybe not in the same way it might have been useful if poor recoveries had continued after the implementation of your collection program. There are a lot of considerations to be made.

Hurry Up and Wait

FASB has not yet approved the final standard, however, the project is considered to be close to completion. It is expected that there will be quite a long time until implementation is required, however, as you can see, every moment will be precious in preparing to implement the new methodology and its many facets. For those that shifted either on their own or at the suggestion of regulators to shorter timeframe historical information in their current calculations, it may take even more time and effort to develop the data necessary to successfully implement the new standard.

In short, now is the time to get your DATA together!