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The presentation will begin shortly.

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Key Lessons Learned from CECL Implementation

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Jennifer McCahill, CPA
Audit Partner

Alison Conklin, CPA
Audit Senior Manager

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Presenters

Meet the instructors

Jennifer McCahill
Partner

Alison Conklin
Senior Manager

Andrew Deyhle
Manager

Housekeeping

Additional Information

Learning Objective To provide attendees with an overview of lessons learned from CECL implementation.	**Instructional Delivery Methods** Group Internet-based
Recommended CPE 1 CPE Credit	**Recommended Fields of Study** Specialized Knowledge
Prerequisites None required	**Advance Preparation** None
Program Level Basic	**Course Registration Requirements** None
Refund Policy No fee is required to participate in this session.	**Cancellation Policy** In the event that the presentation is cancelled or rescheduled, participants will be contacted immediately with details.
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Polling Question #1

Has the CECL standard impacted your organization?

A. Yes
B. No
C. Unsure

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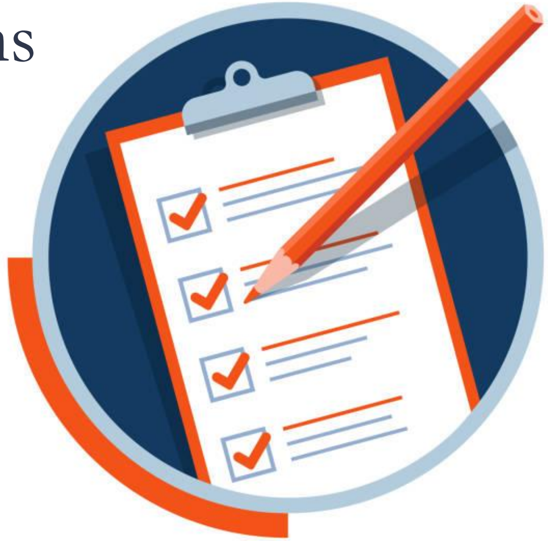
Agenda

1. CECL Standard Overview
2. Lesson #1 – Back to Revenue Recognition Basics
3. Lesson #2 - Real-Life Application of CECL Calculations
4. Lesson #3 - Evolving Guidance and Materiality
5. Lesson #4 - Enhanced Financial Disclosures



Current Expected Credit Loss Standard

Overview

CECL Standard Overview

- **Accounting Standards Update 2016-13: Financial Instruments - Credit Losses (Topic 326)**
- **Implementation Date:** Required for fiscal years beginning after December 15, 2022, for non-public companies. The adoption date for calendar year-ends was January 1, 2023.
- **Scope:** Primarily addresses losses related to financial instruments and loans (e.g., banking), but it also applies to other financial assets, potentially impacting all organizations.
- **Model:** Replaces the incurred losses model and requires consideration of historical, current, and future conditions in the estimated allowance.
- Our focus will be on the implications for the nonprofit sector.

Financial Assets TO Consider Under CECL

- Financial assets IN scope include the following:
  - Accounts receivable related to exchange transactions under ASC Topic 606
  - Notes or loans receivable with unrelated entities
  - Off balance sheet credit exposure, such as guarantees, commitments or letters of credit (i.e., entity is the recipient of potential assets)
  - Assets related to financing leases held by the lessor
  - Any other financial asset not scoped out where the organization has the right to receive cash

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Financial Assets NOT to Consider Under CECL

- Financial assets OUT scope include the following:
  - Contributions receivable (as per ASC Topic 958)
  - Financial assets, such as investments, reported at fair value (as per ASC Topic 820)
  - Loans extended to participants of defined contribution employee benefit plans
  - Intercompany notes or loan receivables, including those between entities under common control
  - Receivables arising from operating leases held by the lessor
  - Derivatives and hedging instruments (as per ASC Topic 815)

Lesson #1 – Back to the Revenue Recognition Basics

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Lesson #1 – Back to Revenue Recognition Basics

Observations:

- **Commingled Revenue:** Revenue subject to CECL and revenue not subject to CECL were often combined or presented together within the chart of accounts
- **Mixed Revenue Vehicles:** Revenue vehicles contained elements of both contributions and exchanges, posing tracking challenges
- **Unsegregated Write-Offs:** Historical write-offs were not segregated by revenue stream
- **Need for Refreshers:** Organizations frequently needed a refresher on Topic 958 versus Topic 606 and sometimes had to revisit revenue recognition practices

Lesson #1 – Back to Revenue Recognition Basics

Contributions

- Voluntary, non-reciprocal transfer of cash, assets, or promises to give to an entity.
- Revenue is recognized upon notification of the award and satisfaction of all conditions, if applicable.
- Individual donations / Grants from Foundations / USG conditional award

Exchange Transactions:

- A reciprocal transfer between two entities that results in one of the entities receiving the same value in return
- Revenue is recognized when the performance obligation is met.
- Fee for service / Program income / events

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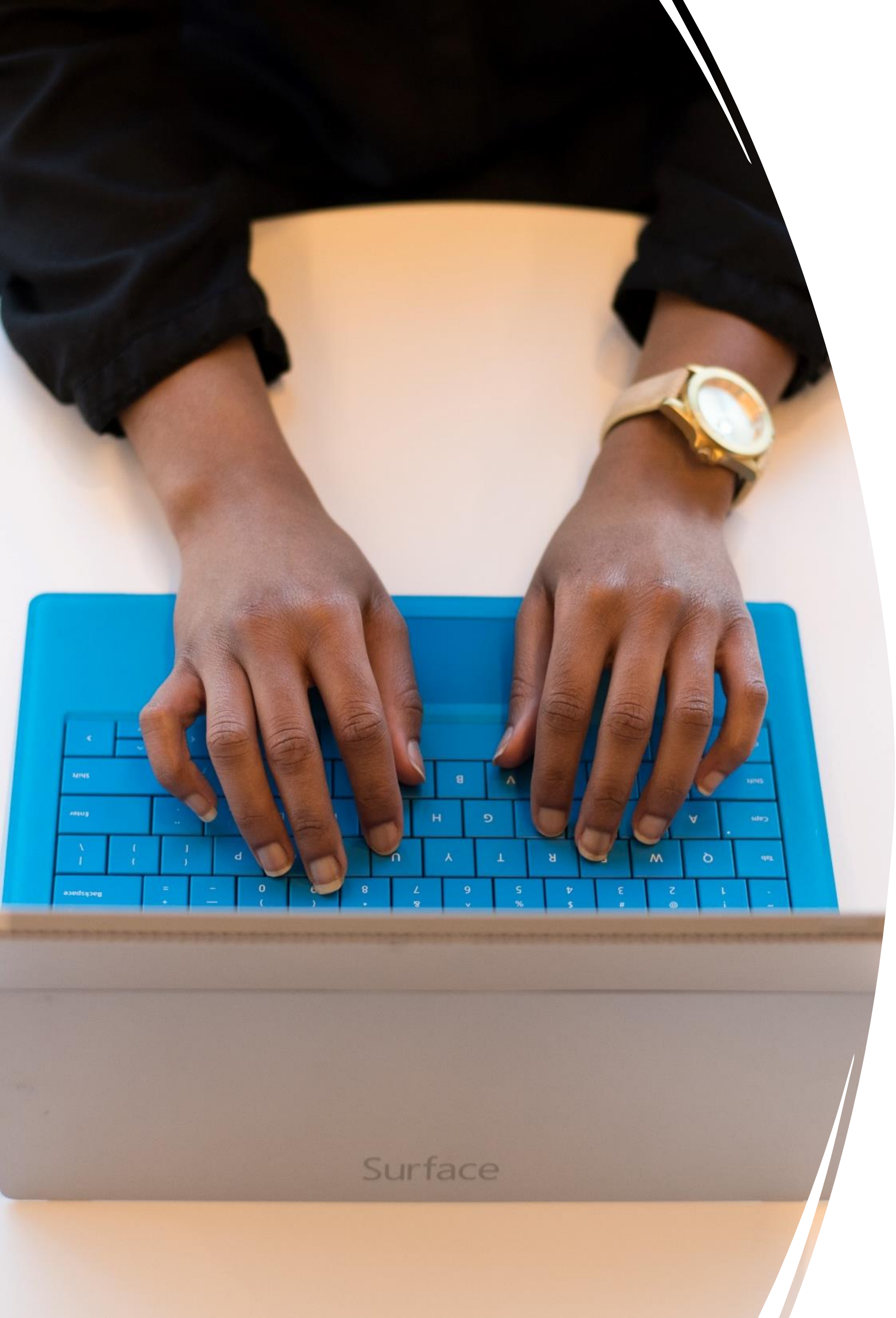
Lesson #1 – Back to Revenue Recognition Basics

<u>What we can do:</u>

- **Separate Accounts:** Avoid mixing contributions/grants with exchange transactions in receivable accounts. Use distinct receivable accounts for various revenue streams
- **Focus on Scope:** Document CECL analysis only for financial assets/receivables that are within scope
- **Documented Policies:** Establish and maintain documented policies and procedures for each significant revenue stream, whether exchange-based or contribution-based
- **Segment Financial Assets:** Group similar financial assets into pools to estimate credit losses more accurately



Real-Life Application of CECL Calculations

Real-Life Application of CECL Calculations:
Historical Loss Data

Observations:

- Organizations typically performed a five-year look back for the basis of their calculations. Reviewed prior year write-offs or uncollectible amounts
- COVID implications – a number of organizations had to consider the impact of COVID in the calculation
- Bad debt needed to be identified as either exchange or contribution to ensure an accurate calculation
- Organizations applied the calculation by receivable aging buckets
- Those without a previous allowance were establishing one for the first time

Real-Life Application of CECL Calculations:

Current Conditions

Observations:

- Retraining needed on thought process for considerations – i.e. subsequent collections
- Organizations with little changes in operations often didn't have adjustments based on current conditions
- Turnover & management policy changes – impacted current conditions
- Certain economic conditions – i.e. election year – impacted some organizations
- Industry changes – i.e. Bureau of Labor statistics and other external considerations

Real-Life Application of CECL Calculations:

Future Conditions

Observations:

- Reasonable and supportable forecasts about future conditions – "future" didn't span beyond a year or two in most cases
- Stabilization of organizations – i.e. turnover had stabilized - resulted in negative adjustments
- Relationship changes – i.e. contacts at agency clients - resulted in upward adjustments
- Change in offerings – i.e. change in membership type - resulted in both upward and downward adjustments

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CECL Example

Customer	Balance	Current	31-60	61-90	>91
Entity A	$ 100,000	$ 75,000	$ 25,000	$ -	$ -
Entity B	200,000	50,000	50,000	50,000	50,000
Entity C	300,000	100,000	100,000	100,000	-
Gross Receivables	600,000	225,000	175,000	150,000	50,000
Less ACL	(133,125)	(7,875)	(19,250)	(64,500)	(41,500)
Net Receivables	**$ 466,875**	**$ 217,125**	**$ 155,750**	**$ 85,500**	**$ 8,500**

	Current	31-60	61-90	>91
Historical loss rates <	0.5%	8.0%	40.0%	80.0%
Current conditions ^	5.0%	5.0%	5.0%	5.0%
Future conditions >	-2.0%	-2.0%	-2.0%	-2.0%
	3.5%	11.0%	43.0%	83.0%

< Historical loss rates are based on the average of actual losses in each category over the past 10 years.

^ Upward adjustment for current conditions because the industry in which customers operate is experiencing challenges.

> Downward adjustment for future conditions because it is expected that the industry will rebound in the next year.

Polling Question #2

Did your organization's CECL analysis indicate a material credit loss allowance for fiscal year 2023?

A. *Yes*

B. *No*

C. *Unsure*

Enhanced Financial Disclosures

Enhanced Financial Disclosures

Observations:

- Impact of adoption could be considered immaterial and result in enhanced disclosures only
- Contract assets and contract liabilities – linking to revenue streams – importance of separation within the GL
- The term 'allowance for doubtful accounts' or 'bad debt expense' was replaced with 'allowance for credit losses' or 'credit loss expense'
- A roll forward of the allowance for credit losses was included in the notes to the financial statements

Allowance for Credit Loss Roll Forward Disclosure

	12/31/2023	
Allowance for credit losses, beginning of year	$	100,232
Additions (charges to credit loss expense)		57,090
Deductions (Write-offs, net of recoveries)		(24,197)
Allowance for credit losses, end of year	**$**	**133,125**

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Contract Assets and Contract Liabilities Disclosures

Contract assets consisted of the following revenue streams as of:

	12/31/2023	12/31/2022
Contract services	$ 821,250	$ 793,630
Membership dues	64,720	58,690
Lease income	18,000	14,500
Less: Allowance for credit losses	(133,125)	(100,232)
TOTAL CONTRACT ASSETS	**$ 770,845**	**$ 766,588**

Contract liabilities consisted of the following revenue streams as of:

	12/31/2023	12/31/2022
Contract services	$ 27,124	$ 34,550
Membership dues	221,800	211,176
TOTAL CONTRACT LIABILITIES	**$ 248,924**	**$ 245,726**

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Polling Question #3

How frequently will your organization review its CECL analysis?

A. *Monthly*
B. *Quarterly*
C. *Yearly*
D. *Unsure*

Evolving Guidance for Lessons Learned & FAQs

Evolving Guidance and Zero Credit Loss

- Challenging to justify a zero provision (even with historically no losses) – Current and Future
- According to the Center for Plain English Accounting, it is theoretically possible, based on the plain language of FASB ASC 326, to support a zero expected credit loss assertion for trade accounts receivable. This is feasible in cases where historical experience shows zero credit losses, and both current conditions and reasonable, supportable forecasts continue to indicate zero credit losses.
- Document the rationale and provide evidence to support the reliability and accuracy of economic scenarios and forecasts.

Center for Plain English Accounting FAQs

Can subsequent events, such as collection of trade receivables, after the balance sheet date be considered in developing a measure of credit losses under FASB ASC 326 (CECL)?

It depends.

The Board decided that when determining an estimate of credit losses, an entity should not recognize in the financial statements the effects of any events that occur after the balance sheet date but before financial statements are issued or are available to be issued. However, subsequent events should be reflected in the estimate of credit losses if an entity determines an error correction is necessary under Topic 250, *Accounting Changes and Error Corrections*.

Center for Plain English Accounting FAQs

Since FASB ASC 606 requires collection of the consideration expected to be probable in order to recognize revenue (in Step 1), why is any credit loss necessary under CECL and FASB ASC 326 for trade receivables already subject to FASB ASC 606?

A CECL reserve under FASB ASC 326 needs to be considered even if revenue has satisfied the aforementioned probability of collection threshold for two reasons:

1. CECL lacks a recognition threshold and requires measurement of remote risks of credit losses (FASB ASC 326-20-30-10) which could include remote risks of credit losses which properly satisfy the "probable" of collection recognition threshold of FASB ASC 606-10-25-1e.

2. The unit of account under CECL is typically much broader than the unit of account under FASB ASC 606. The unit of account under FASB ASC 606 is either the contract or the individual performance obligation. However, the unit of account to measure credit losses under FASB ASC 326 is required to be much broader based on the pooling notion in FASB ASC 326-20-30-2. Therefore, a loss measure developed for a collective pool for CECL likely will be applied to contracts for which the "probable" of collection threshold under FASB ASC 606-10-25-1e has been properly satisfied.

Center for Plain English Accounting FAQs

In developing a measure of credit losses under CECL (FASC ASC 326) can we solely use historical experience and not consider current conditions and reasonable and supportable forecasts?

No.

FASB ASC 326-20-30-9 indicates that, “[a]n entity shall not rely solely on past events to estimate expected credit losses. When an entity uses historical loss information, it 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.”

FINAL REMINDERS

- Even if your nonprofit has never previously recorded an allowance for doubtful accounts, auditors will expect to see an allowance for credit losses as of January 1, 2023, and December 31, 2023.
- Nonprofits can no longer use the direct write-off method.
- Nonprofits will not be able to assert that all receivables are 100% collectible without substantial documentation, using the CECL framework to support that assertion. Even if the risk of loss is considered highly remote, nonprofits are still required to estimate the lifetime credit losses for financial assets within the scope of the new standard.
- Unlike the previous incurred loss model, the new expected loss model does not specify a threshold for recognizing an ACL.
- Nonprofits must document their ACL analysis as of January 1, 2023, using historical data, current conditions, and future expectations.
- **Share the documentation with your auditors** before your audit starts to avoid surprises or significant audit adjustments.

Questions?

Contact Us

CPAs & ADVISORS

Offices in DC and NYC

Serving clients across the globe

301-951-9090 | www.grfcpa.com

Jennifer McCahill
Partner
jmccahill@grfcpa.com

Alison Conklin
Senior Manager
aconklin@grfcpa.com

Andrew Deyhle
Manager
adeyhle@grfcpa.com

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